

# **2015 BIENNIUM BUDGET AND GENERAL FUND REVENUE TREND UPDATE**

A Report Prepared for the  
**Legislative Finance Committee**

By  
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## INTRODUCTION

The purpose of this report is to provide the committee with an update to the projected general fund ending balance for the 2015 biennium and to discuss emerging budget issues of all funding sources. Although the revenue and disbursement data for the fund have been finalized on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), the Generally Accepted Accounting Principles (GAAP) balance shown in this report reflects only the adjustments made to date by the Department of Administration (DOA). The general fund account has not yet been audited by the Legislative Auditor, as the audited balance is normally finalized in December.

In addition, this report includes an in-depth analysis of general fund revenues and an updated look at the trends for the 2015 biennium. Staff has updated the revenue estimating models with current data and done minor improvements in modeling techniques.

## FUND BALANCE DISCUSSION

As shown in the chart below, the preliminary general fund unaudited and unassigned balance for FY 2013 was \$537.3 million. In September, the projected FY 2015 ending fund balance was \$348.6 million. The updated projected ending fund balance shown below is \$347.1 million, or a reduction of \$1.5 million. This reduction includes minor changes in appropriations, primarily \$1.4 million of carry forward appropriations that were established based on MCA 17-7-304(4), and other minor adjustments. Aside from these small changes, no adjustments are included from SJ 2 revenue and session expenditure estimates for FY 2014 and FY 2015.

<b>General Fund Update December 2013</b>				
(in Millions)				
	Actual FY 2012	Actual FY 2013	Budget FY 2014	Budget FY 2015
Beginning Fund Balance	341.9	452.4	537.3	383.5
Revenue	1,871.0	2,077.6	2,056.4	2,136.6
<b>Total Funds Available</b>	<b>2,212.8</b>	<b>2,530.0</b>	<b>2,593.7</b>	<b>2,520.1</b>
Disbursements				
Ongoing				
HB 2, HB 13, and pension bills	1,577.9	1,613.5	1,755.6	1,832.3
Statutory	171.2	199.7	260.9	278.0
Transfers	15.5	15.9	13.6	12.1
Other (includes feed bill)	1.4	60.4	16.2	24.0
Reversions			(7.8)	(8.1)
OTO				
HB 2	10.1	13.7	22.7	23.0
Transfers (including \$51.7 wildland fire in FY 2014)	3.7	36.5	145.0	10.9
Other (includes carry forward)		58.3	4.1	0.9
<b>Total Disbursements</b>	<b>1,779.7</b>	<b>1,997.9</b>	<b>2,210.2</b>	<b>2,173.0</b>
Adjustments	19.2	5.2		
<b>Ending Fund Balance (Unassigned/Unaudited)</b>	<b>452.4</b>	<b>537.3</b>	<b>383.5</b>	<b>347.1</b>

## REVENUE ANALYSIS

This section of the report highlights the year-to-date revenue collections through the end of November FY 2014, and provides an overview by revenue source of the impact of new data and revised modeling on revenue trends.

### SUMMARY OF UPDATED TREND REVENUES

Although the updated revenue trends will not be incorporated into the official revenue estimate, the changes could have a small, positive impact on the ending fund balance. The chart below takes the updated trend totals and subtracts the potential fire fund transfer due to the increased corporation tax trend. The difference between the net updated trend and SJ 2 is summed over the biennium to produce a potential increase to the ending fund balance of \$3.9 million.

Potential Fund Balance Impact of Updated Trend ( in Millions)				
	FY 2014	FY 2015	FY 2016	Total Impact
Updated Trend	\$2,064.4	\$2,138.2		
Less Potential Corp Transfer to Fire Fund	-	1.7	4.1	
Net Updated Trend	\$2,064.4	\$2,136.6	(\$4.1)	
Less SJ 2	2,056.4	2,136.6	-	
Potential Change to Fund Balance	\$8.0	(\$0.0)	(\$4.1)	
Potential Change Total				\$3.9

### FY 2014 YEAR-TO-DATE REVENUE

FY 2014 general fund revenues through the end of November are \$10.3 million or 1.5% ahead of FY 2013 revenues through the same period; this increase is above the anticipated growth of -1.0%. The income level for the FY 2014 forecast in SJ 2 is lower than the actual collections received in FY 2013, which is why anticipated growth is negative.

About half of the increase can be attributed to the top seven revenue sources. Individual income tax continues to increase over FY 2013. Strong growth may continue through January 2014, as CY 2013 quarterly estimated payments are likely to be based on elevated CY 2012 income. The increase in individual income tax is offset by a sharp decrease in corporation income tax. Year-to-date differences for all major revenue sources are discussed in further detail in the next section.

General Fund Revenue Monitoring Report (in Millions)							
Revenue Source	Actual FY 2013	SJ2 Estimate* FY 2014	SJ2 Estimate % Difference	11/30/2012 FY 2013	11/30/2013 FY 2014	YTD Difference	YTD % Change
Largest Seven Sources							
Individual Income Tax	\$1,047.790	\$1,039.082	-0.8%	\$467.876	\$494.723	\$26.848	5.7%
Property Tax	244.607	245.287	0.3%	11.955	11.452	(0.502)	-4.2%
Corporation Tax	177.497	154.096	-13.2%	63.906	42.926	(20.980)	-32.8%
Vehicle Taxes & Fees	99.352	102.659	3.3%	33.152	35.590	2.438	7.4%
Oil Severance Tax	98.683	99.336	0.7%	-	-	-	
Insurance Tax	61.678	52.021	-15.7%	12.757	10.645	(2.112)	-16.6%
Video Gaming Tax	57.261	59.929	4.7%	14.104	14.049	(0.055)	-0.4%
Other Business Taxes							
Drivers License Fee	4.527	4.435	-2.0%	1.729	1.461	(0.268)	-15.5%
Investment Licenses	6.951	7.457	7.3%	0.832	0.945	0.112	13.5%
Lodging Facilities Sales Tax	16.720	18.365	9.8%	6.689	6.767	0.078	1.2%
Public Contractor's Tax	(0.138)	3.259	-2468.7%	(0.820)	1.927	2.747	-335.1%
Railroad Car Tax	2.179	2.320	6.5%	1.586	1.602	0.016	1.0%
Rental Car Sales Tax	3.523	3.632	3.1%	1.489	1.440	(0.049)	-3.3%
Retail Telecom Excise Tax	20.652	23.236	12.5%	4.162	4.120	(0.042)	-1.0%
Other Natural Resource Taxes							
Coal Severance Tax	13.265	14.857	12.0%	4.358	3.763	(0.595)	-13.6%
Electrical Energy Tax	5.067	4.521	-10.8%	1.085	0.909	(0.176)	-16.2%
Metal Mines Tax	10.049	10.595	5.4%	0.005	0.008	0.003	64.9%
U.S. Mineral Royalties	29.205	30.953	6.0%	8.576	8.674	0.099	1.2%
Wholesale Energy Trans Tax	3.558	4.140	16.4%	0.863	0.795	(0.068)	-7.9%
Other Interest Earnings							
Coal Trust Interest Earnings	24.153	24.354	0.8%	6.395	5.443	(0.952)	-14.9%
TCA Interest Earnings	2.465	2.346	-4.8%	0.993	0.707	(0.285)	-28.7%
Other Consumption Taxes							
Beer Tax	3.033	3.067	1.1%	1.143	1.149	0.006	0.5%
Cigarette Tax	31.011	30.433	-1.9%	13.100	12.654	(0.446)	-3.4%
Liquor Excise Tax	17.724	19.284	8.8%	6.232	6.440	0.208	3.3%
Liquor Profits	10.500	11.080	5.5%	-	-	-	
Lottery Profits	13.084	14.342	9.6%	-	-	-	
Tobacco Tax	5.853	6.005	2.6%	2.114	2.240	0.126	5.9%
Wine Tax	2.195	2.218	1.0%	0.767	0.789	0.022	2.8%
Other Sources							
All Other Revenue	36.578	32.548	-11.0%	13.613	16.164	2.551	18.7%
Highway Patrol Fines	4.140	4.467	7.9%	1.379	1.355	(0.024)	-1.8%
Nursing Facilities Fee	4.928	4.740	-3.8%	1.246	1.223	(0.023)	-1.9%
Public Institution Reimbursements	16.212	17.802	9.8%	1.827	3.416	1.589	87.0%
Tobacco Settlement	3.321	3.519	6.0%	-	-	-	
Largest Seven Subtotal	\$1,786.868	\$1,752.411	-1.9%	\$603.749	\$609.387	\$5.637	0.9%
Remaining Sources Subtotal	290.754	303.974	4.5%	79.363	83.991	4.628	5.8%
Grand Total	\$2,077.622	\$2,056.385	-1.0%	\$683.112	\$693.378	\$10.265	1.5%
* SJ 2, Adjusted for Legislative Impacts							

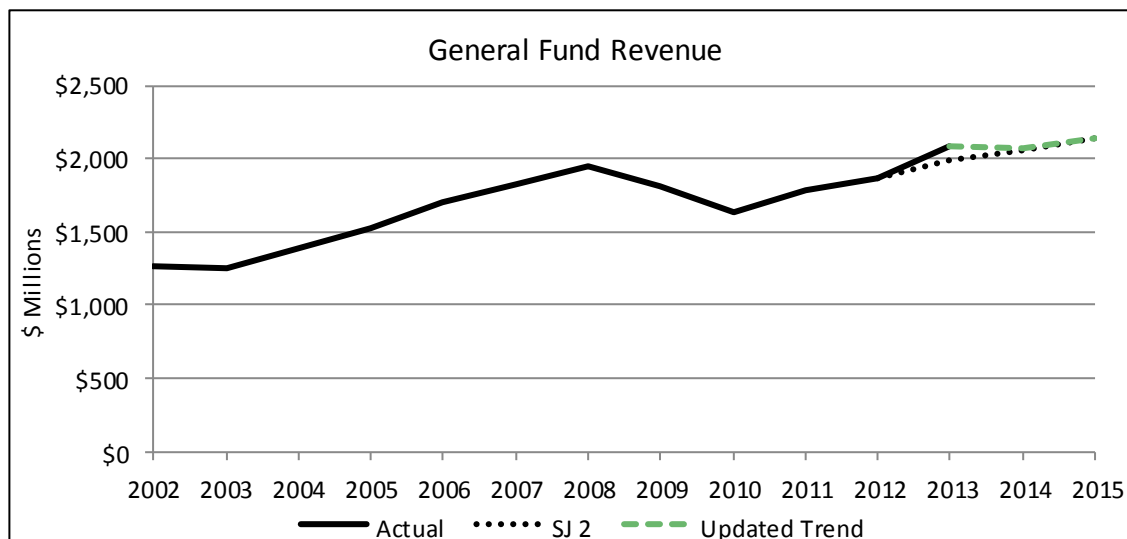
## UPDATED REVENUE TRENDS

The updated revenue trends for each source reflect a combination of changes in base year data, revised assumptions, modeling adjustments, and new IHS forecasts. While it is instructive to see the impact of the new data on expected revenue trends, it is important to note that no changes have been made to the official estimate contained in SJ 2. The updated revenue trends in this report are informational only.

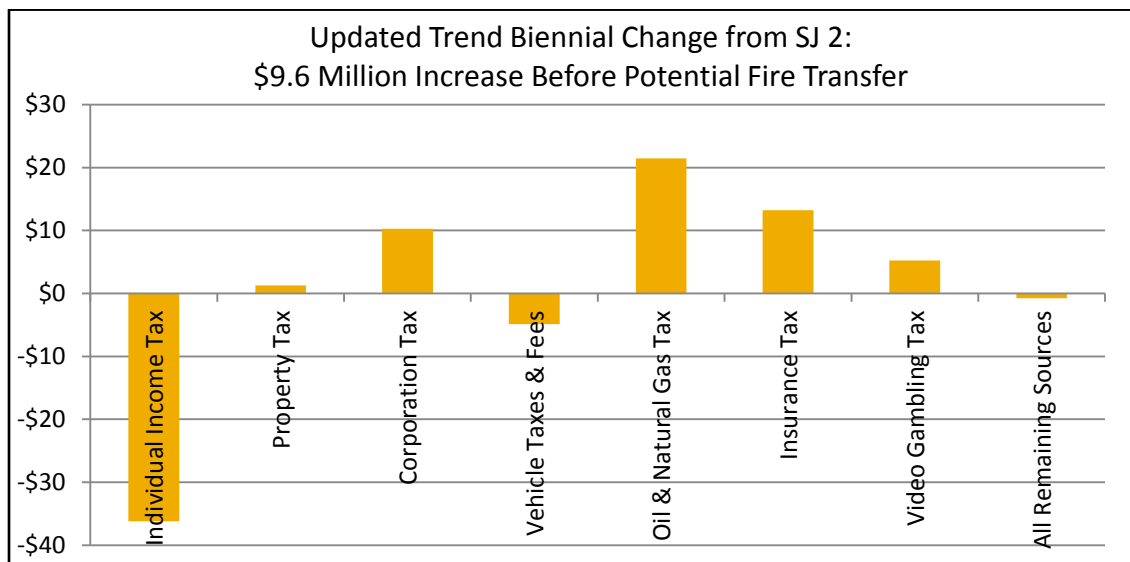
The new data available since the adoption of SJ 2 includes the following sources:

- FY 2013 revenue collections
- New individual and corporation tax return data, and property valuation data
- New oil and natural gas production data
- Revised coal, metal mine, and wholesale and electrical production estimates from surveys
- Updated IHS forecasts

All revenue trend graphs show actual collections from FY 2002 through FY 2013, the SJ 2 estimate from FY 2013 through FY 2015, and the updated trend for FY 2014 and FY 2015. The aggregate of the individual updated trends compared to the total SJ 2 general fund estimate is shown in the chart below. FY 2013 revenues were higher than anticipated, but the SJ 2 estimate for FY2014 and FY 2015 appears consistent with the updated trend.

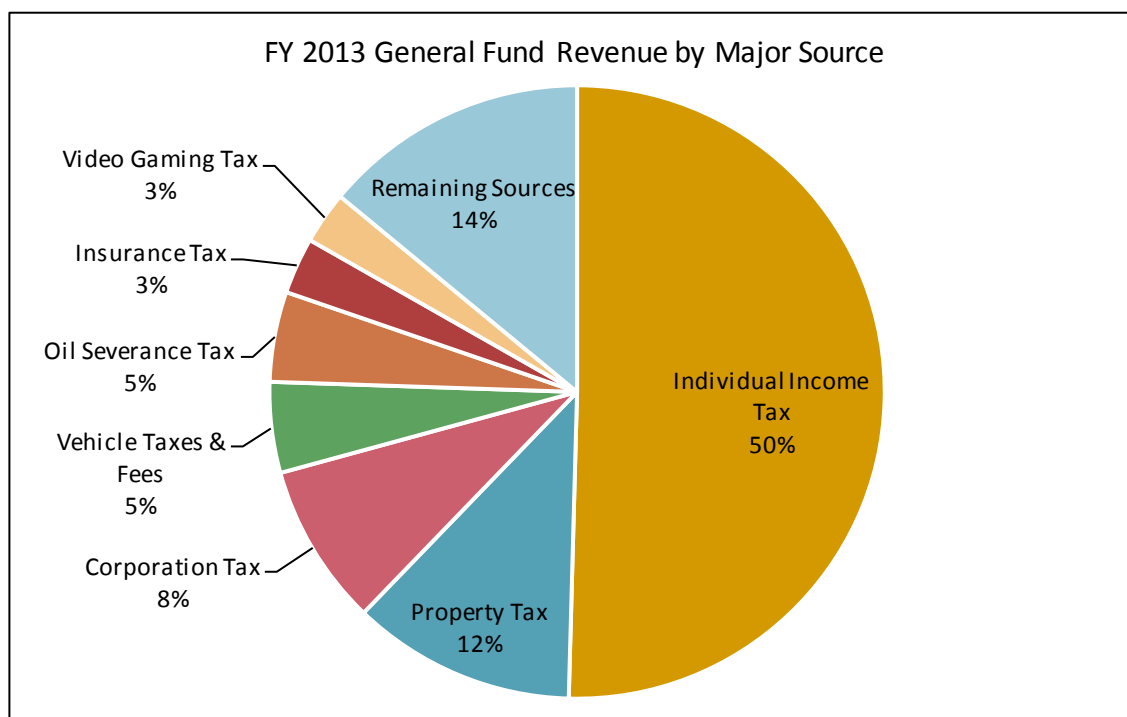


Total biennium impacts of the updated trends by source are shown below:



## Large Revenue Sources

In FY 2013, the largest seven revenue sources accounted for 86% of total general fund revenue. This section will highlight the updated trends with each source and further revenue detail if applicable.



## Individual Income Tax

Individual income tax collections through the end of November are \$26.8 million, or 5.7% above the year-to-date collections in FY 2013. All accounts are contributing to the increase, as shown in the following table:

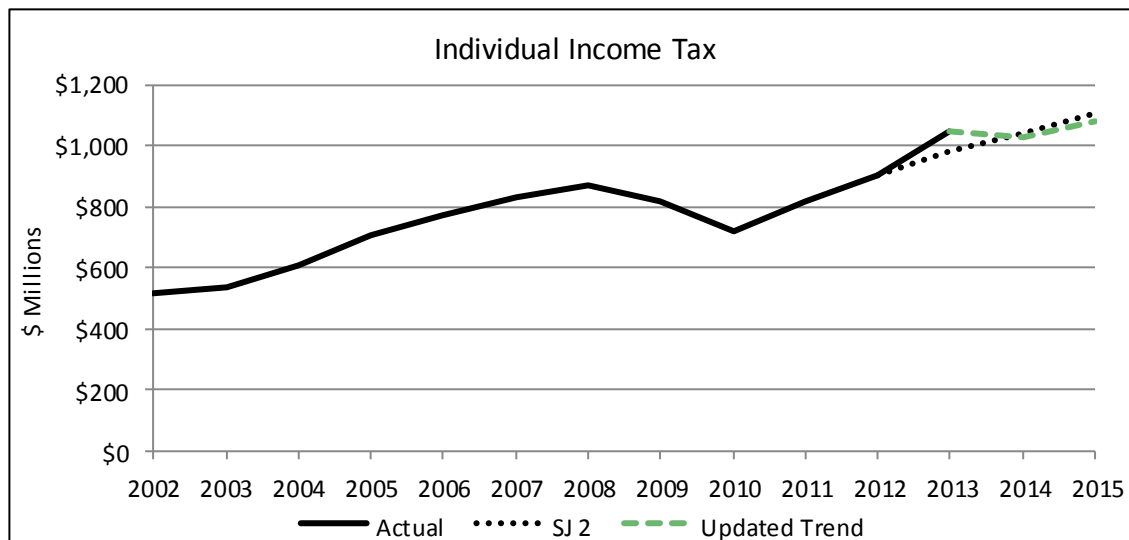
Year-to-Date Individual Income Tax (\$ Millions)				
	FY 2014	FY 2013	Difference	% Difference
Withholding	\$298.4	\$290.8	\$7.5	2.6%
Estimated Payments	81.5	77.8	3.6	4.7%
Current Year Payments	20.0	15.8	4.1	25.9%
Audit, P&I, Amended	9.2	8.6	0.6	6.9%
Refunds	(51.8)	(55.4)	3.6	-6.5%
Refund Accrual Reversal	129.1	124.8	4.3	3.4%
Partnership Income Tax	2.7	1.6	1.1	71.8%
Mineral Royalties	5.8	3.8	2.0	51.6%
Total	\$494.7	\$467.9	\$26.8	5.7%

Individual income tax collections were \$63.8 million above the FY 2013 estimate contained in SJ 2. The updated trend includes the FY 2013 actual collections, as well as CY 2012 tax data and data from the most recent IHS forecast.

There has been significant speculation regarding the impact of the federal tax uncertainty and the end of CY 2012:

- Did the potential for higher tax rates result in taxpayers accelerating capital gain realization?
- Did the potential for higher tax rates result in corporations paying increased dividends?
- Did the increased level of estimated and current year tax payments reflect growth in non-wage income?
- How might income acceleration into 2012 be accounted for in subsequent years?

The remainder of this section summarizes the known estimate errors and corresponding explanations, as well as adjustments included in the model. The updated trend based on the new data and revised modeling is just slightly below the estimate contained in SJ 2.



### Error Analysis

Error can be generated four main ways in the individual income tax estimate:

- Estimated growth rates for income and deduction items
- IHS forecast
- Tax simulation model
- Fiscal year conversion

The CY 2012 error impact in FY 2013 estimated collections is summarized in the following table and explained in greater detail in the subsections below.

Summary of CY 2012 Error on FY 2013 Collections (\$ Millions)	
Source	Amount
Underestimate of two major growth rates	\$10
Underestimate of all other growth rates	6
IHS forecast error	7
Model error	12
<b>Total</b>	<b>\$35</b>



### *Growth Rates*

Growth rates for each type of income, addition, reduction, and itemized deduction are developed using the historical return data and various economic indicators. Estimate error can result from unusual historical data, use of incorrect economic indicators, and the inaccurate forecast growth of economic indicators. Note that the release date of the IHS forecast is important and impacts accuracy of the forecast. The IHS data used in SJ 2 contained only a rough estimate of the impact of the “fiscal cliff” and no indication of the government shutdown, while the data used to produce the updated trend includes a much better measure of the “fiscal cliff” impacts and also makes an estimate of the government shutdown impact.

Growth estimates can be compared to actual growth from the tax return data. The following table compares the income levels forecast in SJ 2 with actual CY 2012 data:

Income Levels (\$ Millions)				
	Actual	SJ 2	\$ Diff	% Diff
Wage Income	\$14,686.2	\$14,605.3	\$80.9	0.6%
Interest Income	313.1	372.6	(59.5)	-16.0%
Dividend Income	627.6	472.9	154.7	32.7%
Taxable Refunds	90.1	93.4	(3.3)	-3.5%
Alimony Received	13.2	14.5	(1.3)	-9.0%
Net Business	740.9	735.5	5.4	0.7%
Cap. Gains	1,491.2	1,309.2	182.0	13.9%
Sup. Gains	53.1	48.7	4.4	9.0%
Rents & Royalties	2,340.9	2,140.6	200.4	9.4%
IRA Income	619.0	651.3	(32.3)	-5.0%
Taxable Pensions	1,841.0	1,841.8	(0.8)	0.0%
Taxable Soc. Sec.	721.7	671.5	50.2	7.5%
Farm Income	(135.9)	(108.5)	(27.4)	25.2%
Other Income	(552.9)	(511.3)	(41.6)	8.1%
Total	\$22,849.3	\$22,337.4	\$511.9	2.3%

The underestimate of three sources dividend income; capital gains income; and rent, royalties and partnership income accounted for the majority of the overall income error. Dividend and capital gains income may have been impacted by the federal tax uncertainty at the end of CY 2012, although the increase in either of the sources was not unusual by historical standards.

Using all actual CY 2012 growth rates in the SJ 2 income tax model suggests that the underestimate of these growth rates produced a \$16 million underestimate of FY 2013 collections, with about two-thirds of the difference attributable to the dividend and capital gains income growth rates.

### *IHS Forecast*

IHS data is used to model each of the income types, and several of the additions, reductions, and itemized deductions. Changes in the data whether historical revisions or updated estimates automatically result in changes to the forecast income. In addition, the federal and state income tax brackets are forecast based on changes in the consumer price index (CPI). Even small changes in the CPI can impact the overall revenue estimate.

Using the most recent IHS data in the SJ 2 income tax model suggests that the January 2013 IHS forecast was slightly low for its CY 2012 estimate. This difference produced a \$7 million underestimate of FY 2013 collections.

### *Tax Simulation Model*

The tax simulation model forecasts calendar year, full-year, resident tax liability by applying the growth rates discussed above to each resident taxpayer's income and deduction items. The model makes various determinations on income type, income level, and filing status. These assumptions are used to assign tax rates and applicable deductions, and ultimately the amount of tax liability. The model aggregates all the individual taxpayer information for each income line to produce an estimate of full-year resident, calendar year tax liability.

Combining the most recent IHS forecast with the known CY 2012 growth rates in the SJ 2 income tax model seems to suggest that the simulation model is responsible for an underestimate of about \$12 million.

### *Fiscal Year Conversion*

The fiscal year conversion takes the calendar year, full-year resident liability output of the tax simulation model and adjusts for non-full-year resident liability to produce a total calendar year liability.

#### **Old Conversion Method:**

Previous forecasts have adjusted the total calendar year liability by subtracting all credits other than the capital gains credit, and calculated fiscal year growth rates based on an assumption of equally-spaced timing. These rates were applied to the last fiscal year total collections, excluding audit and penalty and interest collections, and including any base year adjustments, to produce estimated fiscal year collections before audits and other adjustments. Finally, estimated audit, penalty, and interest collections, as well as any other adjustment, are added to produce the final estimate.

Because calculated fiscal growth rates were applied to the last known fiscal year collections, any unusual collection activity was propagated throughout the forecast years. Even if all growth rates were accurate, whether they were applied to an unusually high base year or an unusually low base year, the likely result would be over or underestimating future fiscal year collections. In a past report on FY 2012 FYE collections, it was estimated that a low base fiscal year accounted for nearly two-thirds of the estimate error. Base year adjustments can be made, but there is typically only scant evidence for making these types of adjustments. Furthermore, if the changes are wrong, the method extends the error for all three years of the forecast period.

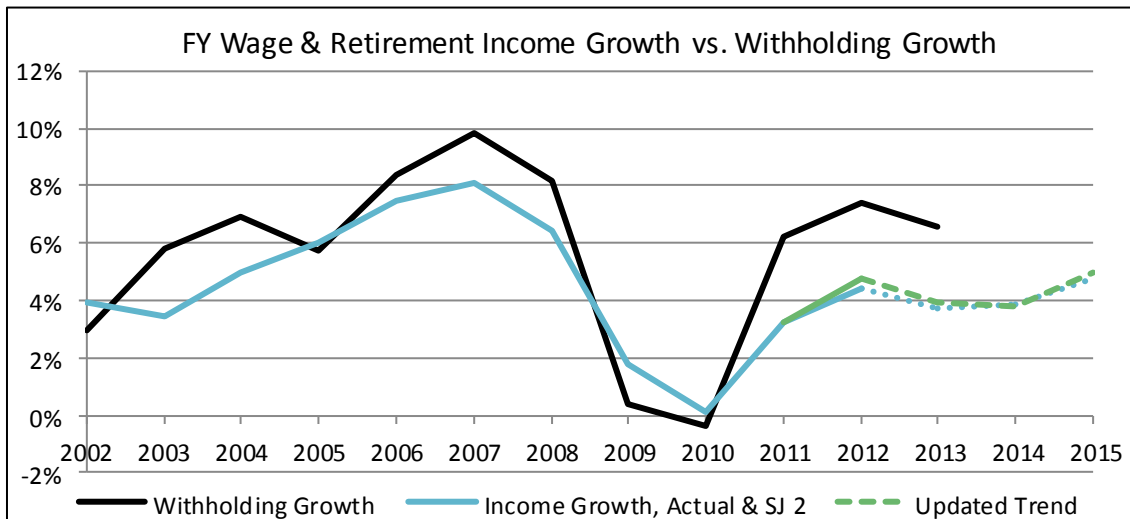
#### **New Conversion Method:**

The revised conversion method models total fiscal year collections less audit, and penalty and interest collections on a one-year lag of total calendar year liability mentioned above. The historical relationship between twenty-one years of fiscal year collections and lagged calendar year liabilities is applied to forecast calendar year liabilities to produce estimated fiscal year collections before audit and, penalty and interest revenue. Aggregated audit, and penalty and interest collections are forecast based on an average ratio to prior years' liability, and added to the fiscal collection to produce a total estimate.

The advantage of using a historical relationship applied to forecast total calendar year liability, rather than applying calculated fiscal year growth rates to the last known fiscal year, is that the estimate becomes much less dependent on any particular year. In years where collections are unusually high or low, reducing this dependence should produce a better estimate.

### Wage and Retirement Income Growth vs. Withholding Growth

There is a correlation between withholding growth and wage income growth. However, the correlation is not particularly strong, as shown in the graph below.

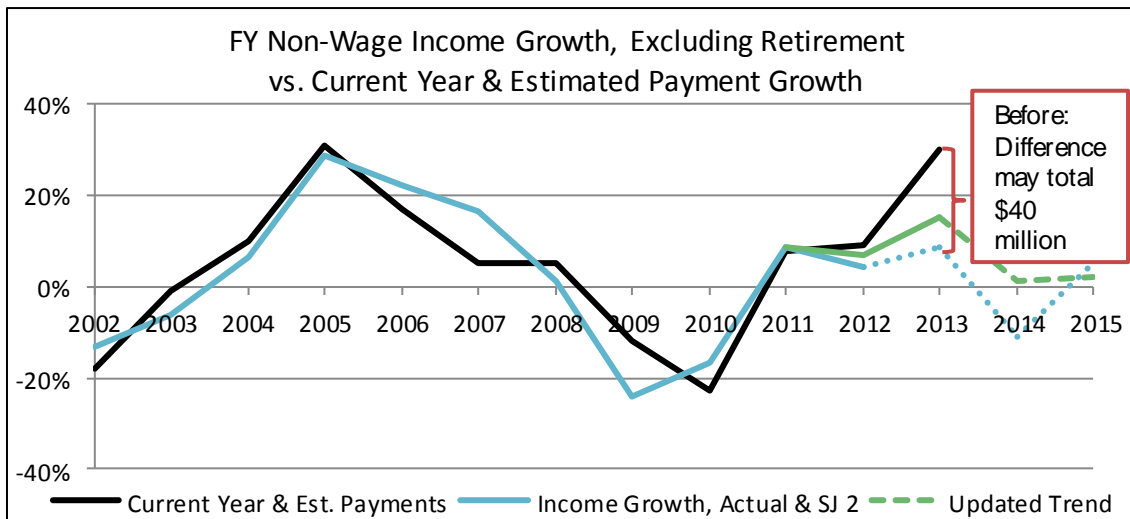


Earlier revenue reports noted that the strong withholding growth could suggest that wage income growth was stronger than estimated in SJ 2. There was a small percentage increase over the estimate, but withholding growth continues to be significantly higher than wage growth.

#### Non-Wage Growth vs. Current Year & Estimated Payments

High estimated and current year payments were significant contributors to the FY 2013 increase. As noted in previous reports, both of these revenue streams were likely impacted by taxpayers' response to the federal tax uncertainty at the end of calendar year 2012.

Prior reports hypothesized that underestimate of growth in non-wage income in FY 2013 could explain about \$40 million of additional income tax collections. However, with the availability of actual CY 2012 tax return data, only about a third of the difference is explained by stronger-than-anticipated non-wage income growth.

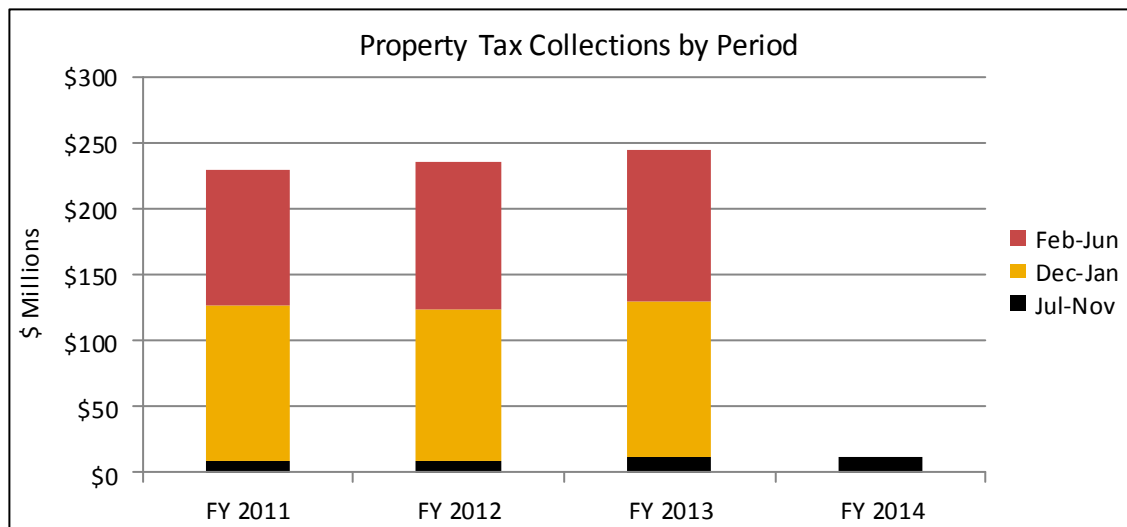


The updated trend for capital gains income includes a leading indicator of changes to the highest marginal tax rate for capital gains income. The addition of the variable improves the historical accuracy of the capital gains income model, and suggests that capital gains income will decrease somewhat in CY 2013.

In summary, of the \$64 million tax revenue increase in FY 2013, only \$35 million can be attributed to known error sources. The remaining nearly \$30 million is primarily due to the growth in current year and quarterly estimated payments. A portion of the increase may reflect larger estimated payments based on the increased CY 2012 income.

### ***Property Tax***

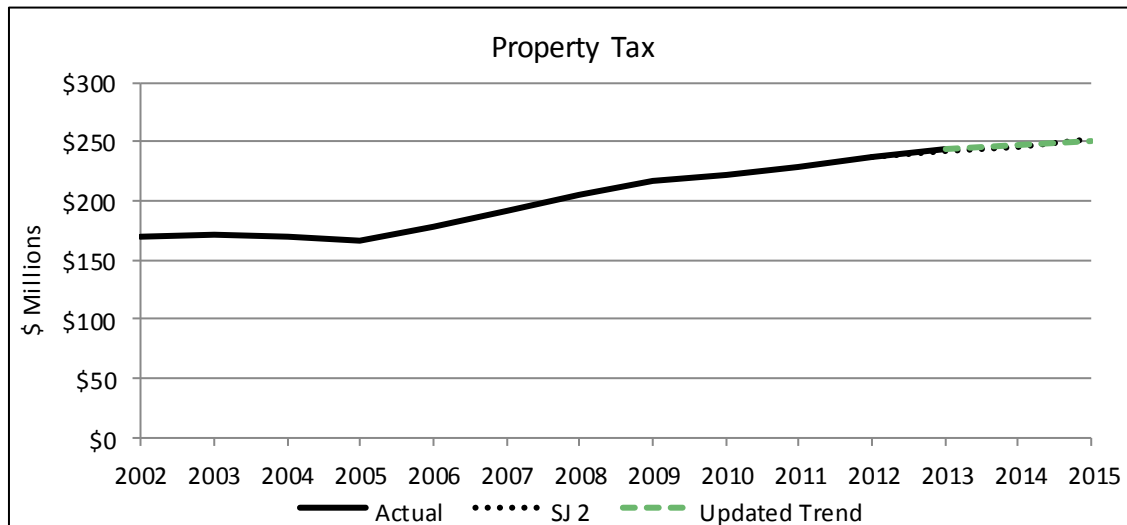
Property tax collections through the end of November are \$0.5 million or 4.2% below collections through the same period in FY 2013. Fluctuations through the first half of the fiscal year are common. Due to the timing of property tax payments, accurate year-to-date comparisons cannot be made until after January. Property tax collections by period are shown in the graph below:



Property tax collections came in \$2.9 million above the FY 2013 estimate in SJ 2. The updated revenue trend includes a reduction in taxable property value for metal mines due to decreased production and a reduction in class 13 property due to a settlement with a major energy producer.

Large Property Tax Differences from SJ 2 (in Millions)		
Reason for Difference	FY 2014	FY 2015
Class 1 & 2 reductions due to metal mines	-\$1.1	-\$1.6
Class 13 reduction due to settlement	-1.3	-1.5
Federal forest extension payments	3.1	
<b>Total</b>	<b>\$0.7</b>	<b>-\$3.1</b>

Despite the net decreases in expected taxable value, the updated trend is slightly above SJ 2 in FY 2014 due to federal forest receipts that were expected to fall to \$0.5 million in FY 2014, but due to a one-time federal extension payments are expected to be \$3.5 million. This extension is not continued into FY 2015, so the decreases in taxable property value result in lower FY 2015 revenue.

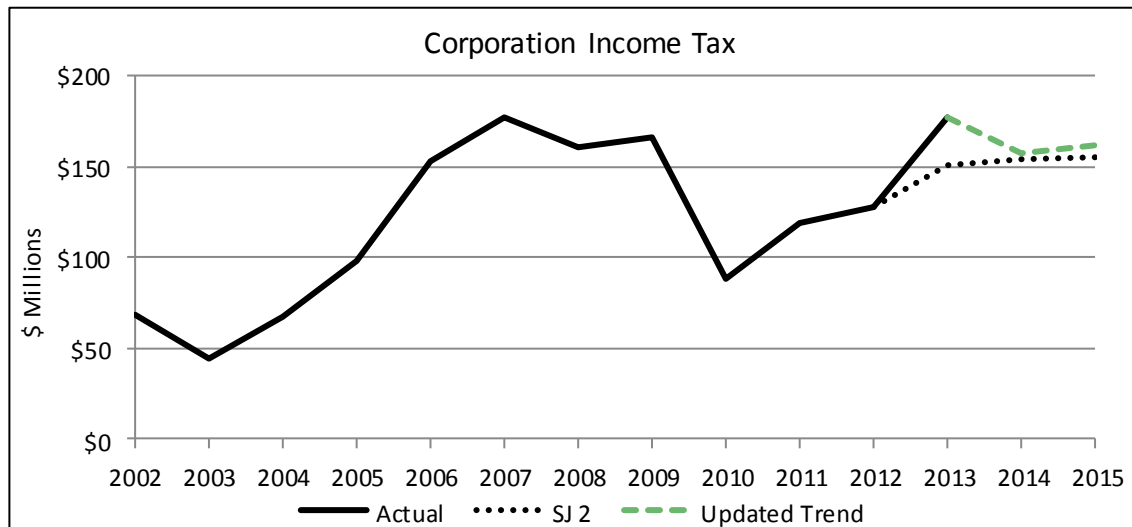


### Corporation Income Tax

Corporation income tax collections through the end of November are \$21.0 million or 32.8% below the year-to-date collections in FY 2013. All accounts are contributing to the reduction, as shown in the following table:

Year-to-Date Corporation Income Tax (\$ Millions)				
Account	FY 2014	FY 2013	Difference	% Difference
Corporation Tax	\$3.4	\$10.7	(\$7.2)	-67.8%
Estimated Payments	36.7	39.0	(2.3)	-5.9%
Refunds	(6.5)	(4.1)	(2.5)	60.5%
Refund Accrual Reversal	5.6	12.8	(7.2)	-56.0%
Audit, P&I, Amended	3.7	5.5	(1.8)	-33.3%
<b>Total</b>	<b>\$42.9</b>	<b>\$63.9</b>	<b>(\$21.0)</b>	<b>-32.8%</b>

Corporation income tax collections were \$26.8 million above the official estimate for FY 2013. The updated trend includes the FY 2013 actual collections, as well as CY 2011 corporation tax data, and data from the most recent IHS forecast. Much of the increase in FY 2013 was due to a large one-time payment and unusually low refunds. These items are not expected to continue, and total tax collections are anticipated to resume at levels near those estimated in SJ 2. Note that any revenue in excess of \$156.2 million in FY 2014 and \$157.5 million in FY 2015 will be transferred to the wildfire suppression fund in the subsequent fiscal year.



No significant modeling changes were made to produce the updated corporation tax trend. Research is just beginning on developing rigorous standard errors for revenue estimates, and results from this research will be used to adjust the growth rate modeling prior to the 2015 legislative session.

#### Error Analysis

Error can be grouped by three main sources in the corporation income tax estimate:

- Growth rates of tax liability by industry sector
- IHS forecast
- Refund and audit estimates

The impact on the FY 2013 estimate by these errors is summarized in the table below.

FY 2013 Error Sources (\$ Millions)	
Source	Amount
Underestimate of CY 2011 sector growth rates	\$11
IHS forecast error	9
Net FY 2013 refund & audit error	8
Total	\$28

Compounding the estimating error is the 18-month lag in actual data. The estimate contained in SJ 2 was based on data for CY 2010, which was still strongly affected by the recession. Data is just now available for CY 2011.

#### *Growth Rates*

Actual CY 2011 tax liability growth rate were 12.2% below the estimates included in SJ 2. The underestimate of the wholesale and retail trade sector accounts for nearly half of the discrepancy and is likely due to being based on recession-level tax liability. Information sector growth was impacted by the sale of a large technology firm in 2011. Information regarding the sale was available at the time of the SJ 2 estimate. However, the impact on tax revenues was not clear, and no adjustment was made at that time.

CY 2011 Tax Liability (\$ Millions)				
Sector	Actual	SJ 2	\$ Diff	% Diff
Agriculture	\$4.4	\$2.7	\$1.7	64.3%
Mining	16.3	14.7	1.6	10.7%
Utilities	0.7	1.0	(0.3)	-27.0%
Construction	2.1	1.1	0.9	84.9%
Manufacturing	38.5	37.4	1.1	2.8%
Wholesale & Retail Trade	19.6	13.8	5.7	41.4%
Transportation	2.4	8.7	(6.3)	-72.2%
Information	4.6	2.0	2.6	132.0%
Professional	7.5	7.1	0.4	5.6%
Large Banks & Holding Companies	25.7	20.0	5.7	28.4%
Social	2.4	2.0	0.5	23.8%
Unknown	0.0	0.2	(0.1)	-97.4%
<b>Total</b>	<b>\$124.2</b>	<b>\$110.7</b>	<b>\$13.5</b>	<b>12.2%</b>

One of the primary goals of developing standard errors for the revenue estimates is to have a tool for measuring the effectiveness of various economic indicators in modeling sector tax liability, and ultimately increasing the accuracy of forecast growth rates. The corporation tax estimate will be one of the first sources to implement this analysis.

#### *IHS Forecast*

IHS data is used to model the tax liability of each sector. Changes in the data whether historical revisions or updated estimates automatically result in changes to the forecast tax liability. Using the most recent IHS data in the SJ 2 corporation tax model suggests that the January 2013 IHS forecast was low for its CY 2012 estimate. This difference produced a \$9 million underestimate of FY 2013 collections.

#### *Refunds*

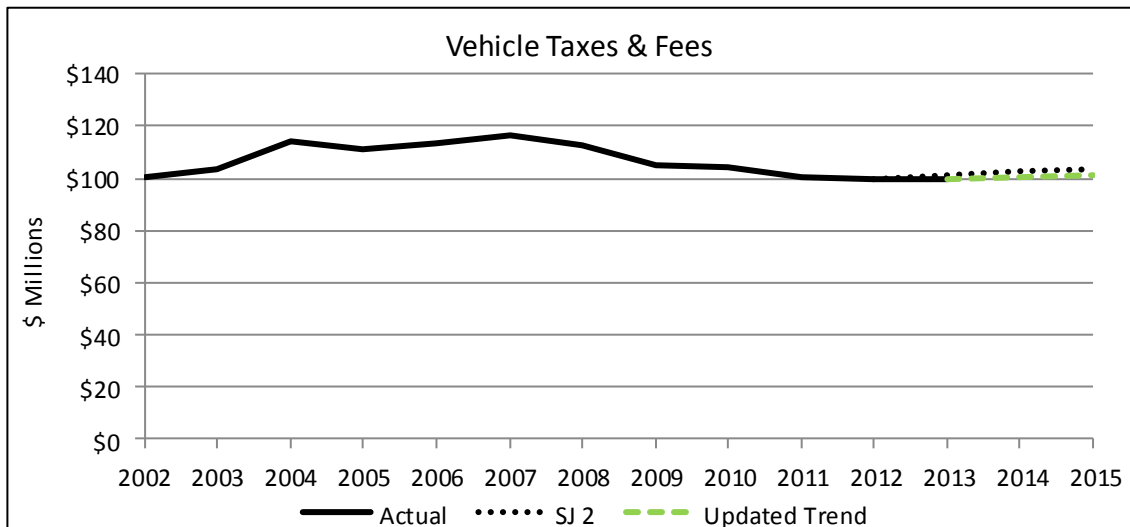
Total refunds, including the FY 2012 accrual reversal in October and the accrual made in June in the state accounting system (SABHRS), were unusually low in FY 2013. Refunds net of the accounting adjustment were close to the level anticipated in SJ 2. The large negative accrual at the end of FY 2012 and the subsequent positive reversal of the same amount in October FY 2013, coupled with the much smaller negative accrual at the end FY 2013, resulted in the low total refund amount as recorded in SABHRS in FY 2013.

As in the SJ 2 estimate, refunds in the updated trend are calculated based on an average ratio of refunds to prior year tax liability. Further modeling updates may attempt to include an adjustment for forecast accruals.

#### *Vehicle Taxes & Fees*

Revenue collections from vehicle fees and taxes through the end of November were \$2.4 million or 7.4% above collections through the same period in FY 2013. This growth represents the first increase in year-to-date revenue since FY 2008, and is in-line with vehicle sales trends.

Combined revenue collections from vehicle fees and taxes were \$1.5 million less than anticipated in SJ 2 for FY 2013. Revenue from this source is forecast based on IHS estimates for new and used Montana car sales. Using these estimates, a growth rate in Montana's vehicle stock is developed to apply to forecast years.

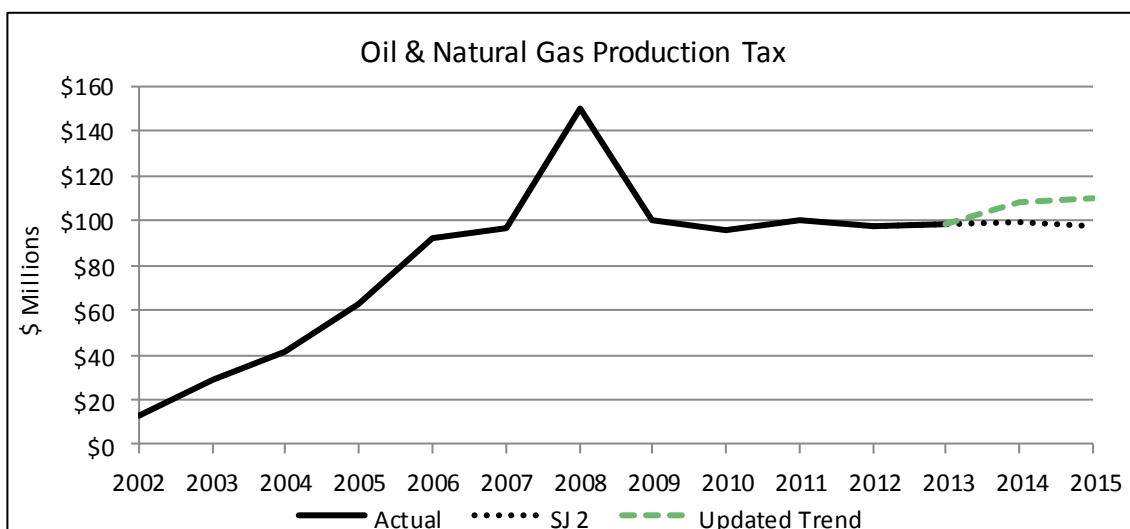


Modeling for this revenue source has not changed. The decline in the updated trend compared to SJ 2 estimates results from revised estimates regarding Montana's vehicle stock and the smaller-than-expected revenue in FY 2013. Modeling will be updated before the 2015 session to include detailed registration data available from the Department of Justice.

### ***Oil & Natural Gas Severance Tax***

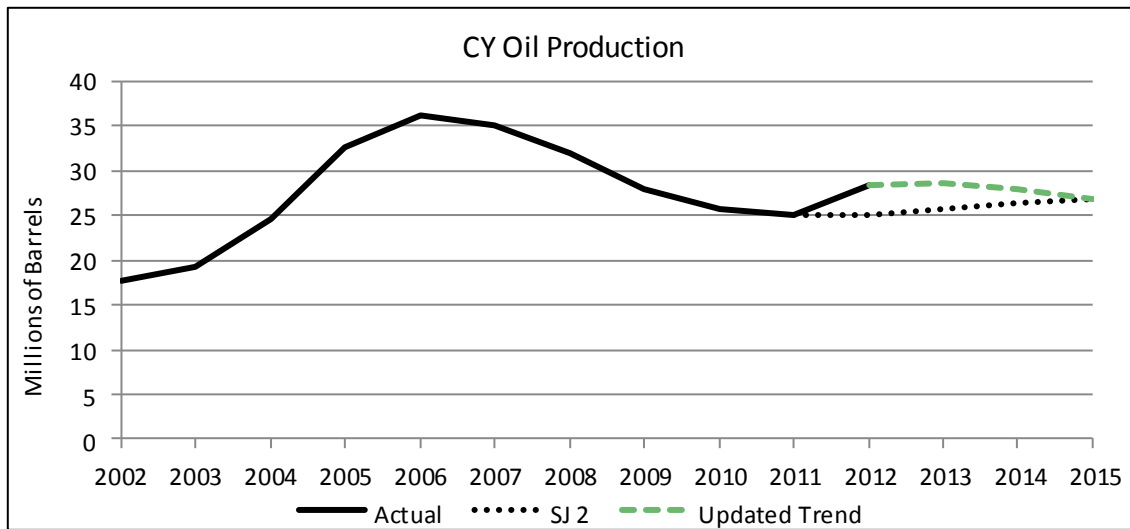
Oil and natural gas production tax collections are \$0 through November. This is expected due to the statutory requirement of when taxes are due and the time allowed for the Department of Revenue to determine the distribution of taxes to local governments.

Oil and natural gas production tax collections were \$0.1 million below the SJ 2 estimate in FY 2013. The consistency of the revenue to the general fund masks changes that are happening in the state as production declines in natural gas have offset the increasing production of oil. The updated revenue trend includes production data through July 2013 as well as higher price forecasts from IHS. These changes, coupled with the relative stability of natural gas value, result in an increase of approximately \$10 million per year over SJ 2.

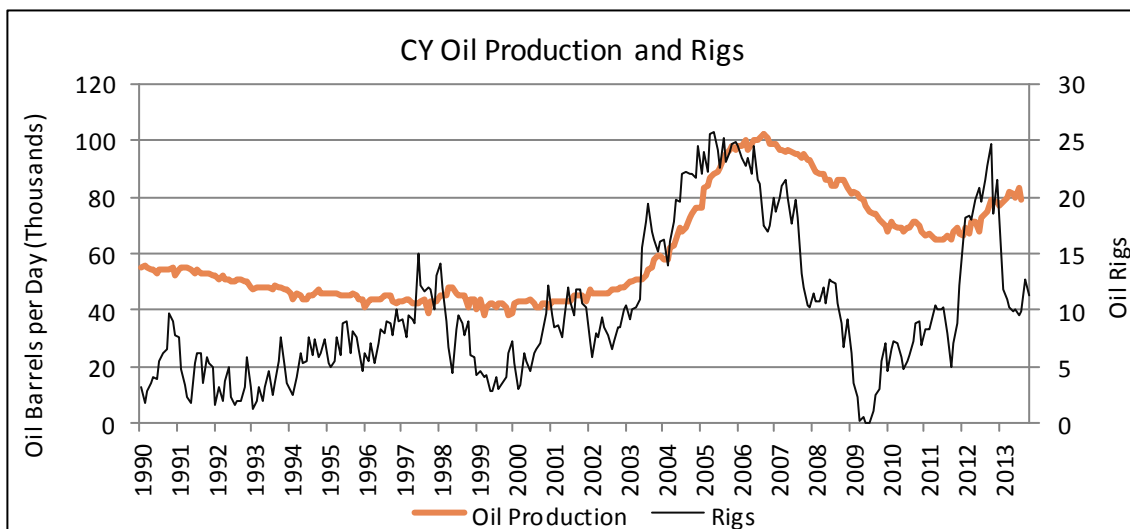




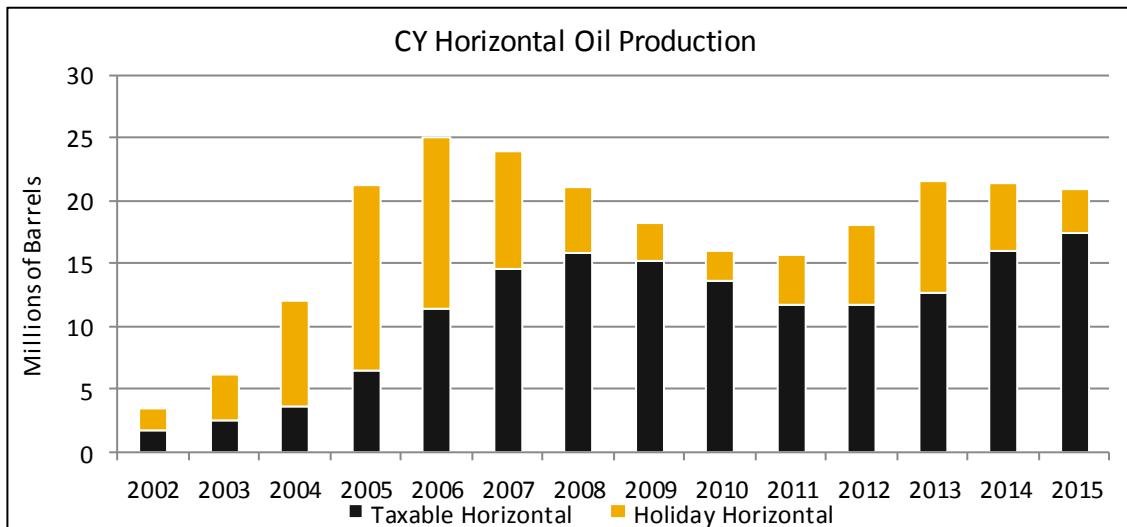
The two factors driving this increased trend are production and price. As shown in the chart below, actual CY 2012 production was above the forecast in SJ 2. Production modeling based the actual values through July 2013 continues the increase with a gradual decline, leading to a convergence of the production line with SJ 2 estimates in FY 2015.



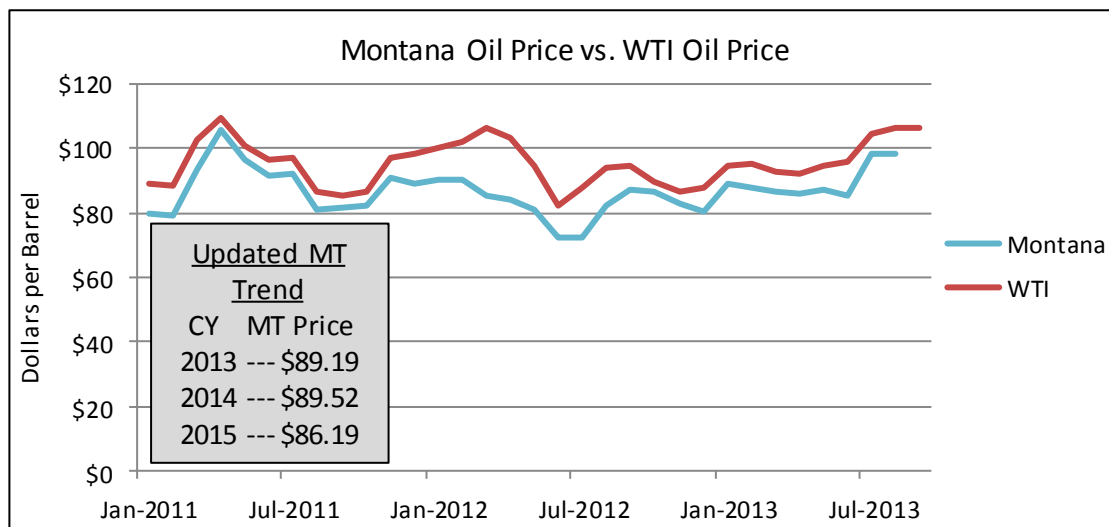
In line with historical patterns, the production increase follows the increased average number of oil rigs in 2012, as shown below.



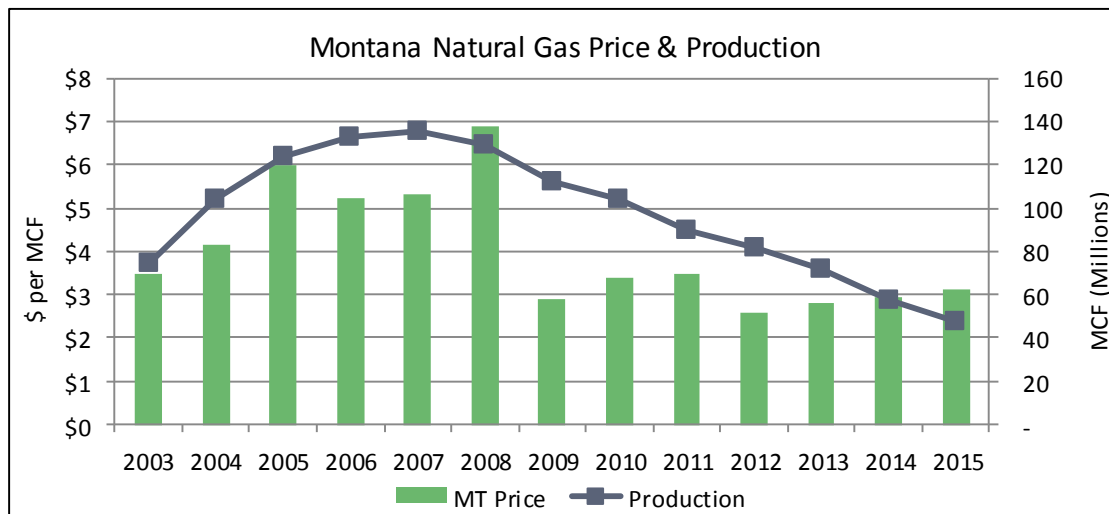
The increase in production is entirely attributable to increased horizontal drilling. The low point in production occurred in CY 2011. Since then, production has been increasing. However, with the 18 month tax holiday, the new production did not contribute significantly to state revenue. The chart below illustrates the new production moving from Holiday Horizontal to Taxable Horizontal, which is the change that affects FY 2014 and FY 2015 revenue.



Along with increases in production, new data from IHS on West Texas Intermediate (WTI) oil prices per barrel have increased the forecasted Montana average oil price. SJ 2 estimated that oil prices would decline below the \$80 per barrel by FY 2015. However, the updated data suggests that the decline in oil prices will be more modest, declining from around \$89 in CY 2013 and CY 2014 to \$86 in CY 2015. The most recent price data for Montana is from August 2013, and the year-to-date average CY 2013 price per barrel is \$89.8, with the current August price at \$98.3.



Gas continues its production decline and relative price stability, similar to SJ 2.



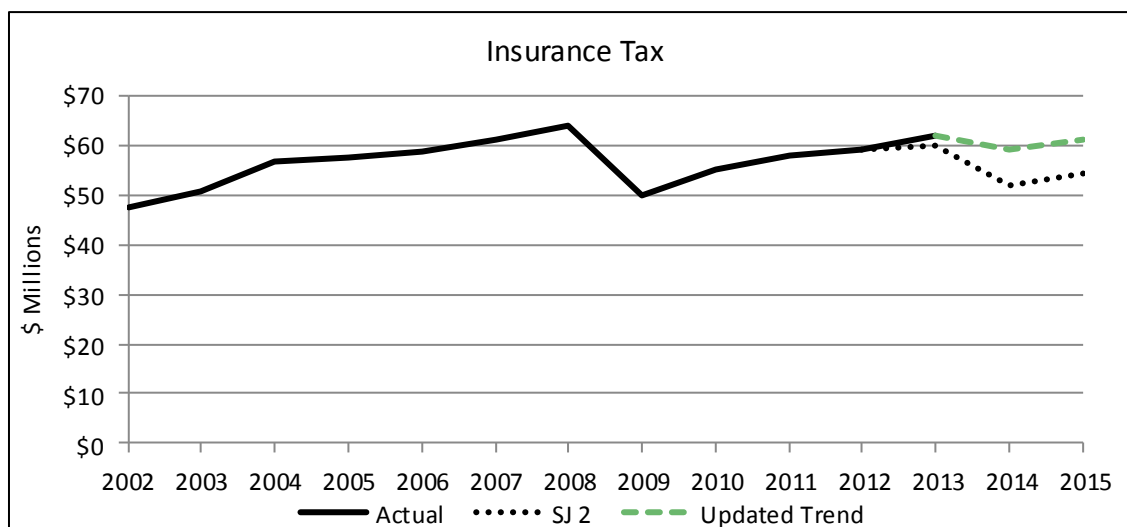
To summarize, the updated trend is above SJ 2, with much of the change based on production increases and higher forecast WTI prices from IHS. Current modeling suggests a return to the production levels forecast in SJ 2.

## Insurance Tax

Revenue collections from insurance taxes through the end of November were \$2.1 million or 16.6% below collections through the same period in FY 2013. This decline is likely explained by timing issues: the increased allocation to the state Children's Health Insurance Program (CHIP) began in July, while higher payments due to the Blue Cross Blue Shield (BCBS) sale began in September.

There are a number of changes that will impact future general fund insurance tax revenue:

- The reversion of the share of the tax deposited into the state special revenue fund for the CHIP back to its original 33% (up from 16.67%) in FY 2014
- The merger of (BCBS) with Health Care Service Corporation (HCSC); as part of the deal HCSC will pay tax from which BCBS was exempt
- The implementation of the Affordable Care Act (ACA)
- The eventual elimination of Montana Comprehensive Health Association (MCHA) offset

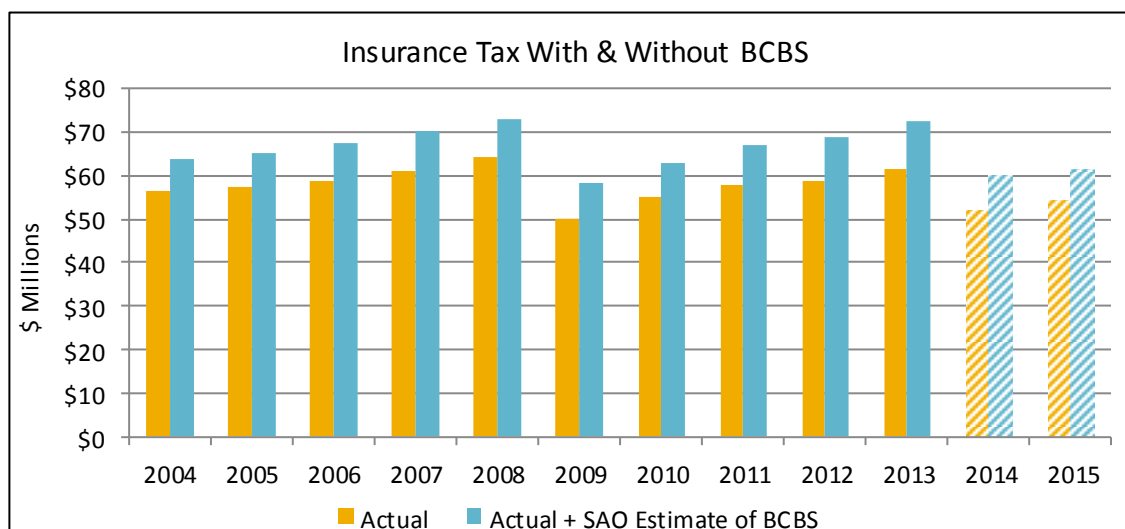


## CHIP

Doubling the proportion of insurance tax revenue allocated to CHIP was the primary driver of the decrease forecast in SJ 2.

## BCBS Merger

In August 2013, BCBS merged with Health Care Service Corporation (HCSC). As a non-profit, BCBS has historically been tax exempt. While that non-profit status continues post-merger, part of the deal as negotiated by the State Auditor is that the company will no longer be tax exempt. The Chief Financial Examiner at the State Auditor's Office (SAO) has examined BCBS premiums since FY 2004 to calculate the tax the company would have paid had it not been exempt. The updated trend is based on the SAO calculation of what insurance tax revenues would have been if those taxes had been collected. The trended point for FY 2014 takes into account that BCBS will only be contributing for 11 of the 12 months of the fiscal year.



## Affordable Care Act

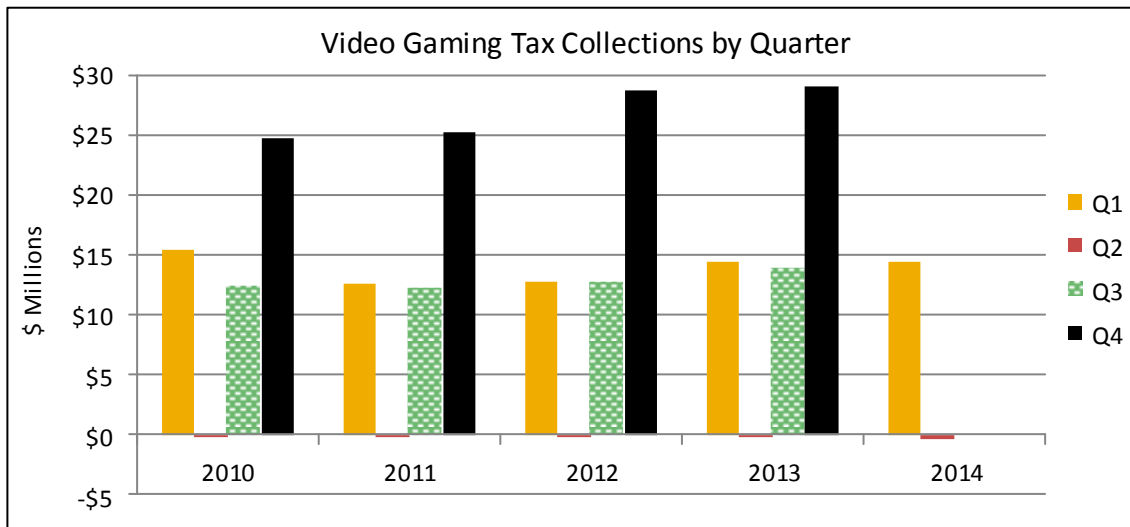
Two of the three companies on Montana's health exchange are tax exempt, including the company with the least expensive coverage plans. While it is impossible to say which plans individuals will choose, the SAO does not anticipate much of an impact on insurance tax revenue as a result of this legislation.

## MCHA Offset

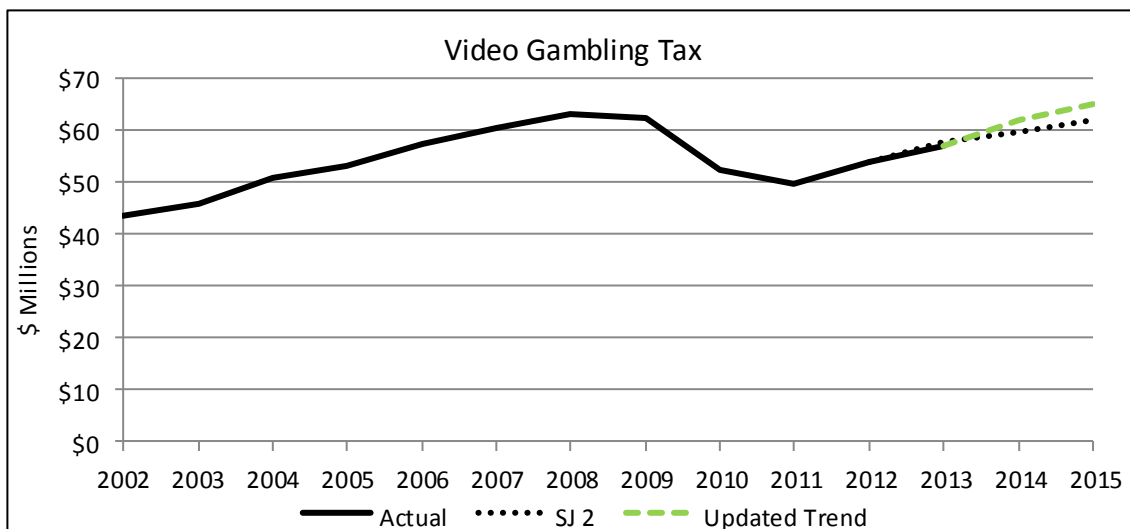
The Montana Comprehensive Health Association (MCHA) offers policies to people who have historically been denied coverage by other insurers. This group will be ceasing business at the end of CY 2013 when people can no longer be denied coverage due to the ACA. Historically, insurance companies have paid part of their tax directly to the MCHA usually a total amount between \$1.5 and \$2.5 million annually that will now go into the general fund.

## ***Video Gambling Tax***

Video gambling tax revenue collections through the end of November were \$0.1 million, or 0.4% below collections through the same period in FY 2013. There was a slight growth through the first quarter, which can be attributed to small reductions so far in the second quarter.



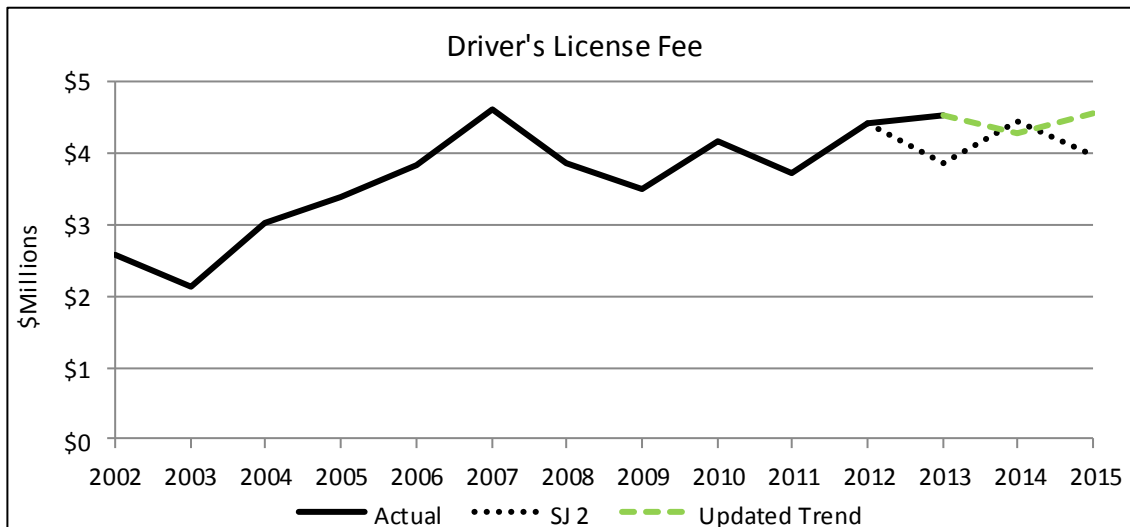
Video gambling revenue was \$0.4 million less than anticipated in SJ 2. Revenue from this source is estimated using IHS forecasts for Montana personal income as well as historical permit and license data. The updated trend is above SJ 2 due to the higher IHS forecast of personal income.



## Other Business Taxes

### *Driver's License Fee*

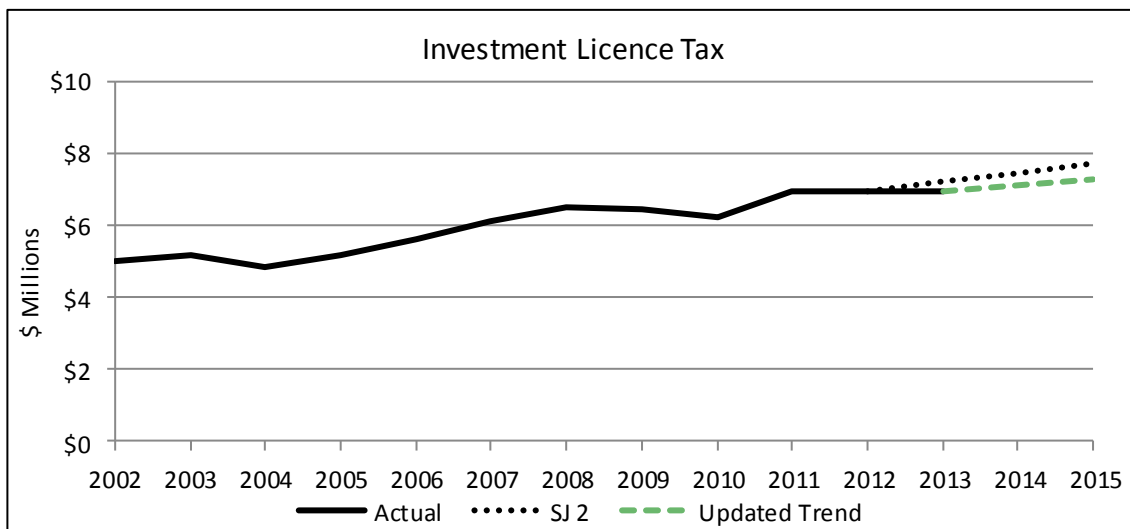
Total driver's license revenue exceeded the estimate contained in SJ 2 by \$0.7 million for FY 2013. Since fees are fixed, this increase was caused by a larger-than-expected number of Class D (standard) driver's license purchases. The SJ 2 estimate was based on the IHS forecast of Montana residents over the age of 16.



The updated trend is based on forecast population data and historical ratios between licenses and actual populations. Actual ratios from the most recent fiscal years are applied accordingly to forecast years.

### ***Investment License Fee***

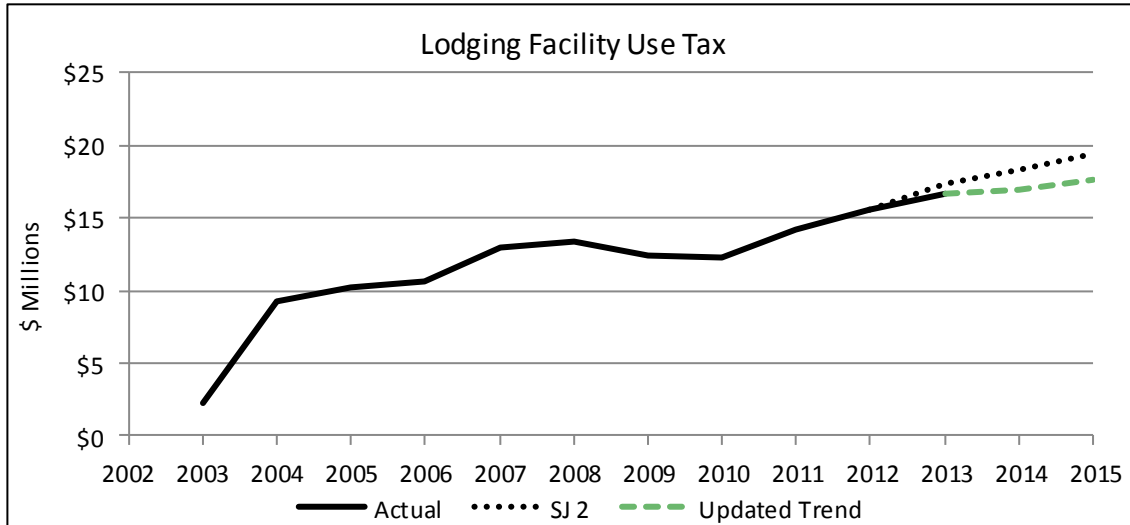
Investment license fee collections were \$0.3 million below the estimate contained in SJ 2 in FY 2013. According to the Deputy Securities Commissioner at the State Auditor's Office (SAO), the reduction in revenue is a reflection of broader changes in the investment industry. As larger investment firms continue to acquire smaller firms and the large firms merge, the total number of firms has been steadily declining. This trend is expected to continue. The growth in the number of individual brokers had been offsetting the reduction in revenue; however, this growth has slowed recently, resulting in the slower investment fee growth.



Collections were forecast in SJ 2 based on the S&P 500 Index and the CPI. With the information from SAO, the updated model also accounts for the declining number of firms.

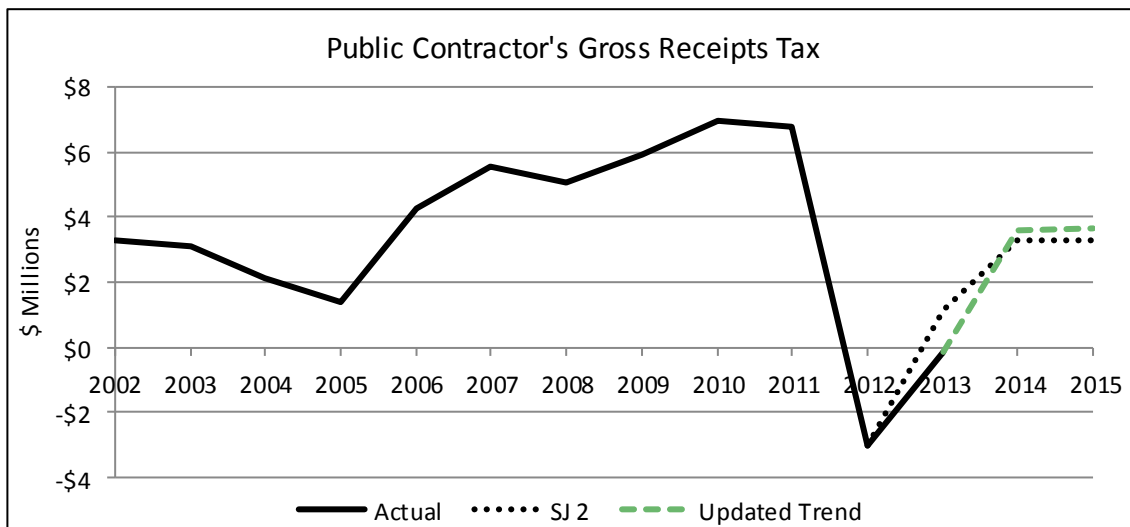
### ***Lodging Facilities Sales Tax***

Lodging facilities sales tax collections were \$0.6 million below the estimate contained in SJ 2 in FY 2013. This revenue source was forecast in SJ 2 based on Montana retail sales, as well as two other variables. The revised model is only based on the IHS forecast of Montana retail sales.



### ***Public Contractor's Tax***

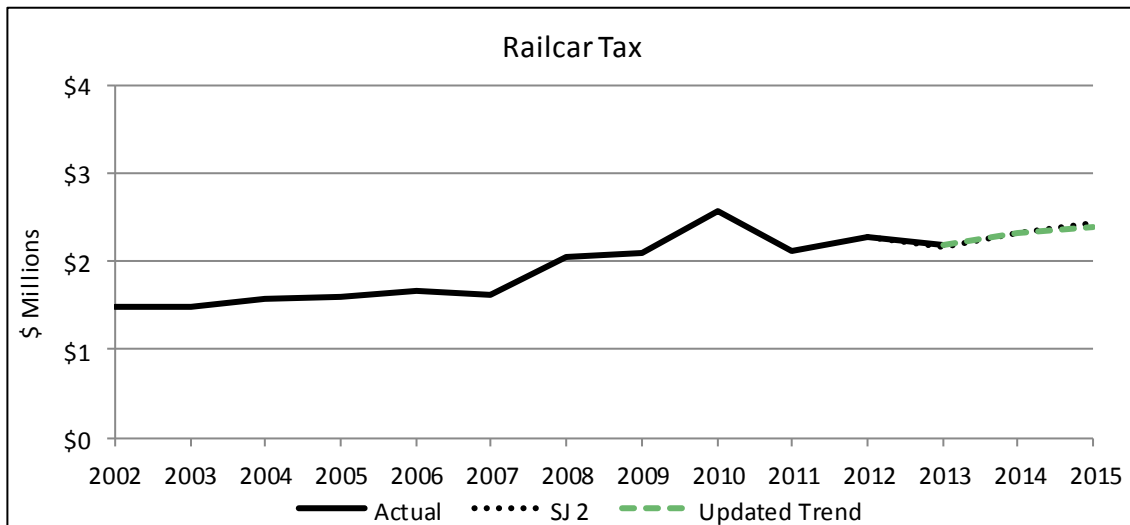
Public contractors' gross receipts tax collections were \$1.3 million below the estimate contained in SJ 2 in FY 2013. Higher levels of credits and refunds due to the increased number of public projects funded through the American Recovery and Reinvestment Act (ARRA) in 2009 and 2010, coupled with the subsequent decrease in publicly funded projects may account for a large share of the net negative income.



This source was estimated in SJ 2 based on budgeted highway construction spending and a ten-year average of other construction. The model was partially revised to account for a strong historical trend in highway construction.

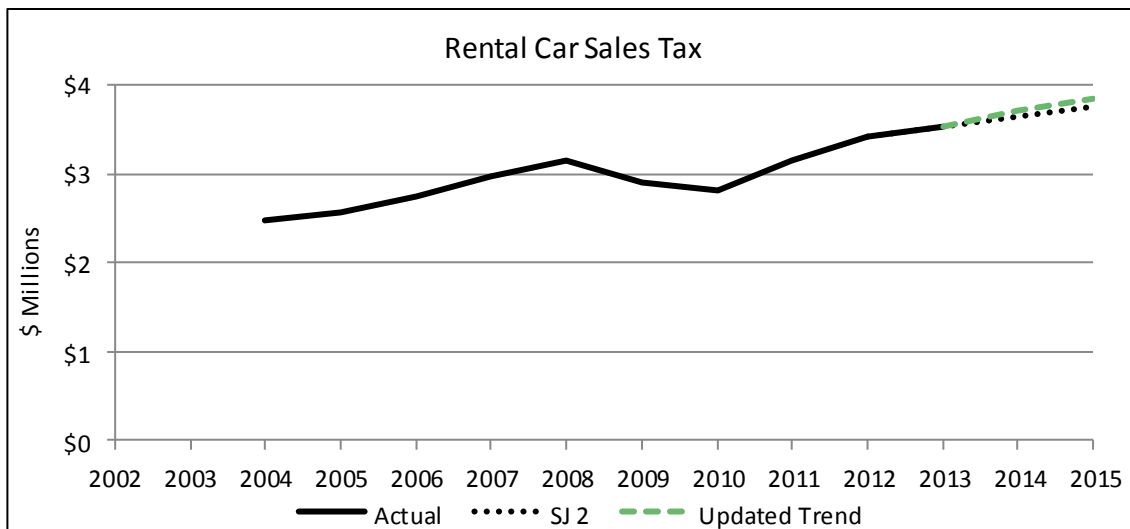
### ***Railroad Car Tax***

Railroad car tax revenue has been reasonably consistent over the last several years, and FY 2013 was no exception. Actual FY 2013 collections were less than 1% above the SJ 2 estimate. The updated trend based on the IHS forecast of Montana retail sales and the calculated railcar tax rate is very similar to that found in SJ 2, as a small decrease in the tax rate is mostly offset by an increase in forecast retail sales.



### ***Rental Car Sales Tax***

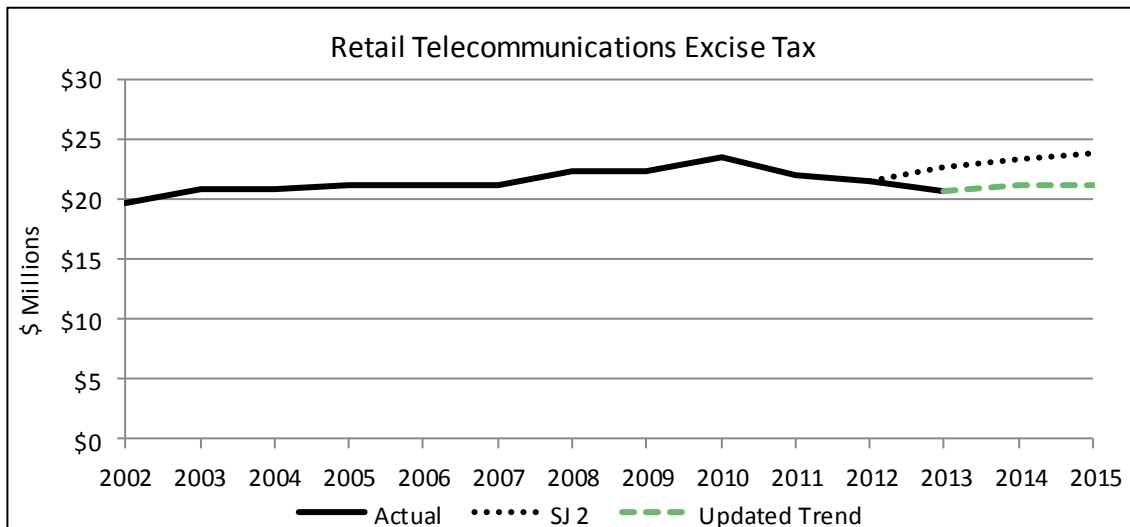
Rental car sales tax collections were very close to the estimate contained in SJ 2 in FY 2013. Rental car sales tax was forecast in SJ 2 based on Montana retail sales. The modeling method has not changed, but a slightly higher forecast of Montana retail sales from IHS resulted in a small increase in this revenue source.



### ***Retail Telecommunications Excise Tax***

Retail telecommunications excise tax collections were \$2.0 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decline in revenue since FY 2011 is the state's 2011 loss of a court case to allow charging the tax on the pre-paid wireless service. According to the Department of Revenue, the impact of the case is an annual reduction in revenue of approximately \$1.0 million.



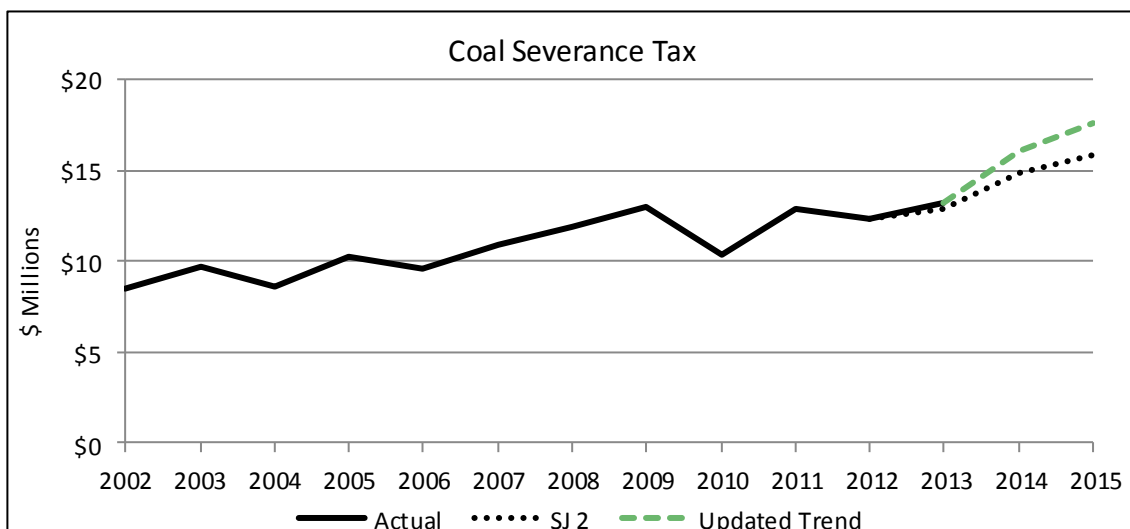


Collections were forecast in SJ 2 based on gross state product (GSP) for the information sector. Revised modeling based on U.S. Census Bureau data for landline use decline and cell phone use growth, and the IHS forecast of Montana population growth, suggests slower growth, which is consistent with recent trends.

## Other Natural Resource Taxes

### *Coal Severance Tax*

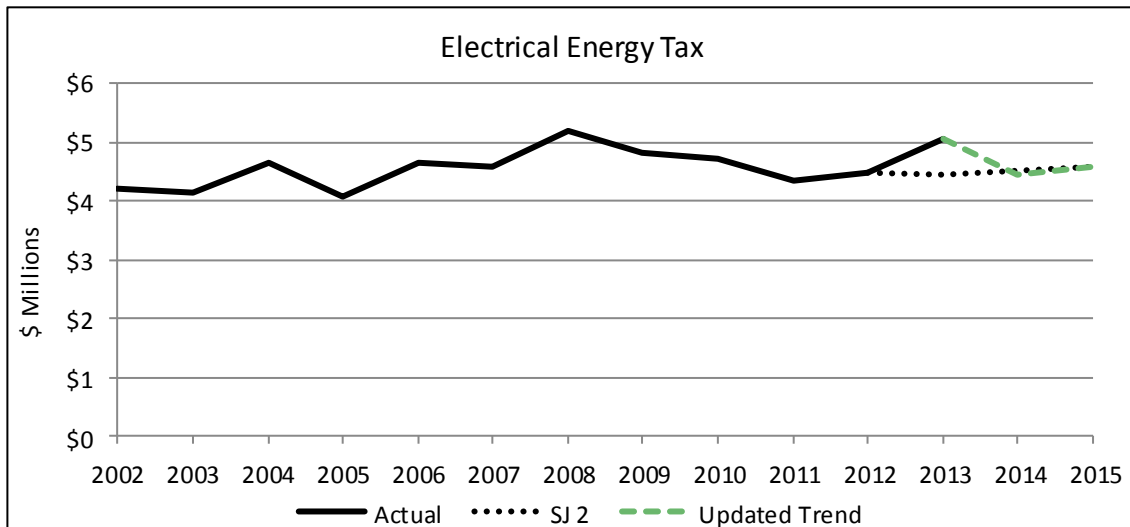
The coal severance tax was above the SJ 2 estimate by \$0.4 million for FY 2013. The updated trend continues the increased growth, based on higher production estimates from coal producer surveys. The contract sales price is consistent with the estimate in SJ 2.



Contributing to the general fund growth is SB 100 from the 61<sup>st</sup> Legislature (2009), which increased the coal severance tax allocation to the coal natural resource account from 2.9% to 5.8%, and expired September 2013. As a result, the allocation to the coal natural resource account has reverted to 2.9%, with the other 2.9% returning to the general fund. This allocation change was included in SJ 2.

## Electrical Energy Tax

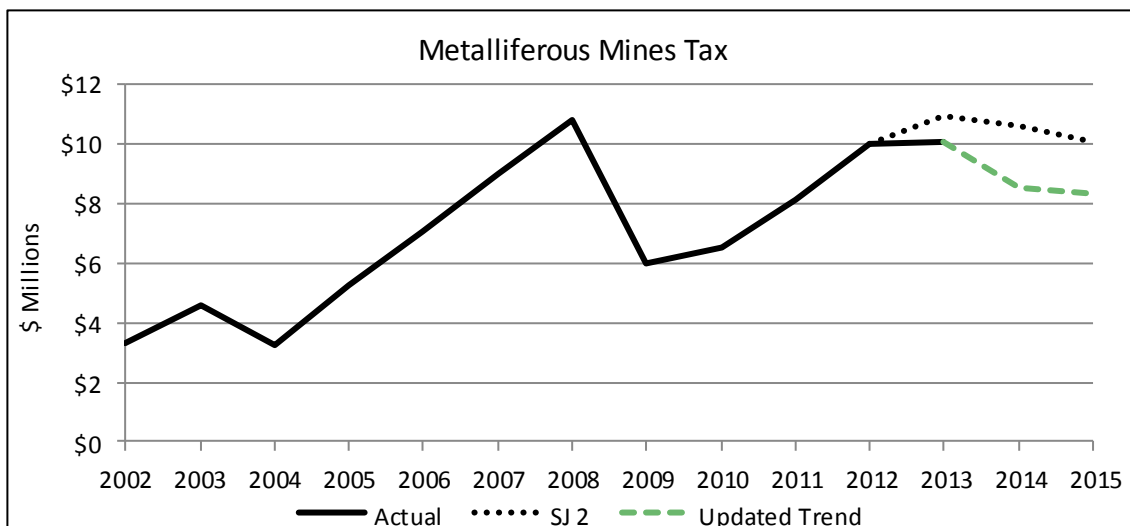
Taxable energy production was below forecast; however, the general fund tax revenue was \$0.6 million, or 14.1% above forecast. This is due to a larger than usual accrual which was calculated based on actual fourth quarter FY 2013 collections that were 15% higher than fourth quarter FY 2012 collections.



The forecast is driven by surveys of electricity producers. New surveys have been conducted, and despite an upturn in production in FY 2013, producers are expecting similar production to the levels contained in SJ 2. Thus, the updated trend converges to the SJ 2 forecast for FY 2014 and FY 2015.

## Metalliferous Mines Tax

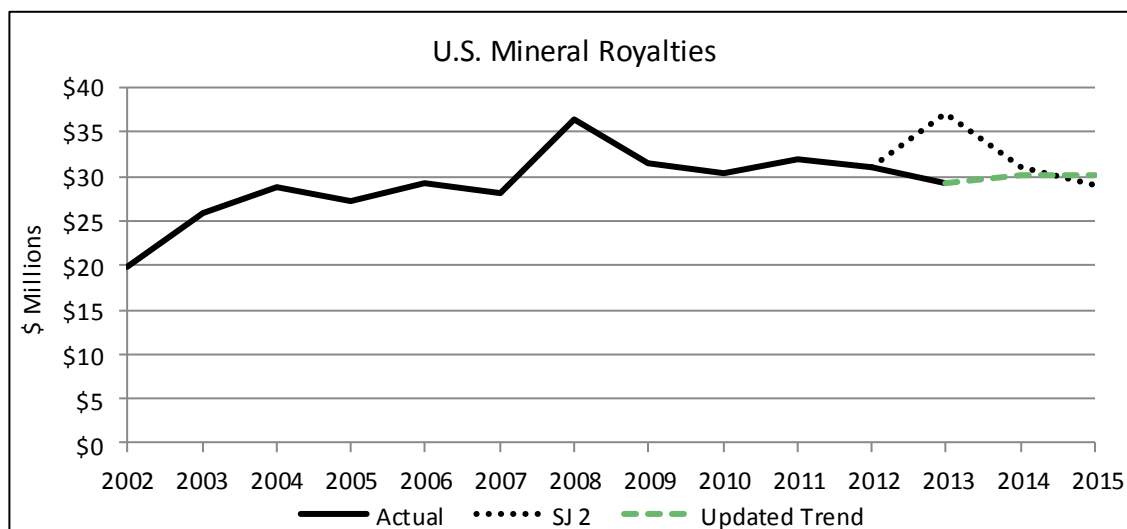
Metal mines tax collections were \$0.9 million below the estimate contained in SJ 2 in FY 2013. The primary reason for the decrease in revenue was the lower-than-forecast prices for most metals.



Based on updated survey information provided by each of the major metal mines producers in the state, overall production will decline for some metals in the forecast period. The decline in production is driving the reduction in expected tax revenue.

## U.S. Mineral Royalties

Revenue from U.S. mineral leases in the state was below estimate in FY 2013 by \$7.8 million. While data from the Federal Office of Natural Resources Revenue is not yet available, the decline is primarily due to two factors: a \$1.6 million decrease in payments due to the sequestration and the loss of the Montana portion of a large oil and gas lease that failed to materialize in McCone County. Donco Inc. paid \$13.3 million for the lease (Billings Gazette 10/24/2012) which was subsequently included in the FY 2013 forecast. The company later backed out of the lease, forgoing a deposit of \$0.3 million (Petroleum News Bakken 05/26/2013).

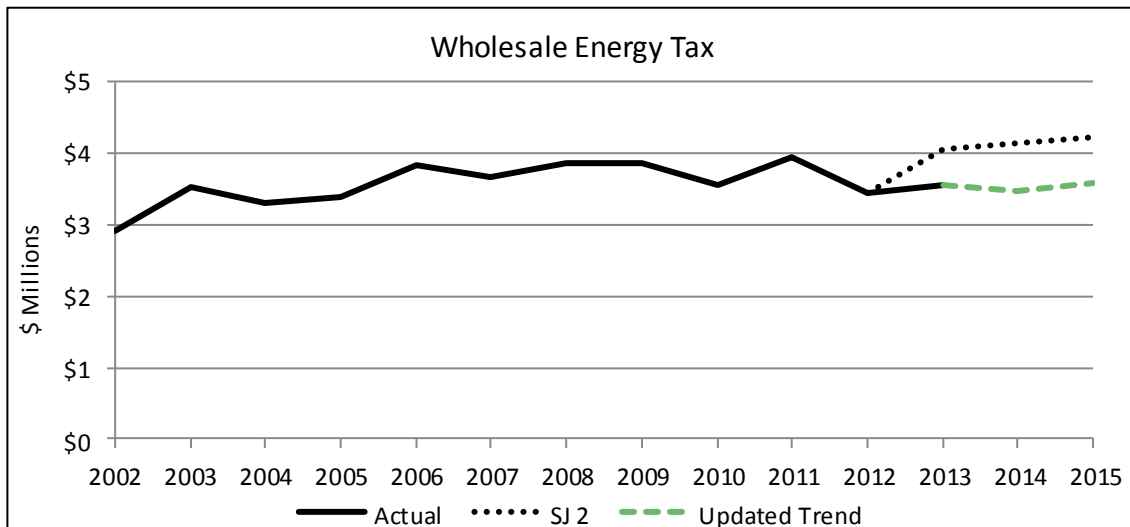


The updated trend includes an increase in FY 2014 primarily due to the \$1.6 million return of the previously sequestered funds, per a U.S. Department of Interior letter. The differences are summarized in the table below:

U.S. Mineral Royalty Differences from SJ 2 (in Millions)		
Reason for Difference	FY 2013	FY 2014
Montana portion of canceled lease	-\$6.2	
Federally sequestered funds	-1.6	
Returned federally sequestered funds		\$1.6
<b>Total</b>	<b>-\$7.8</b>	<b>\$1.6</b>

## Wholesale Energy Transaction Tax

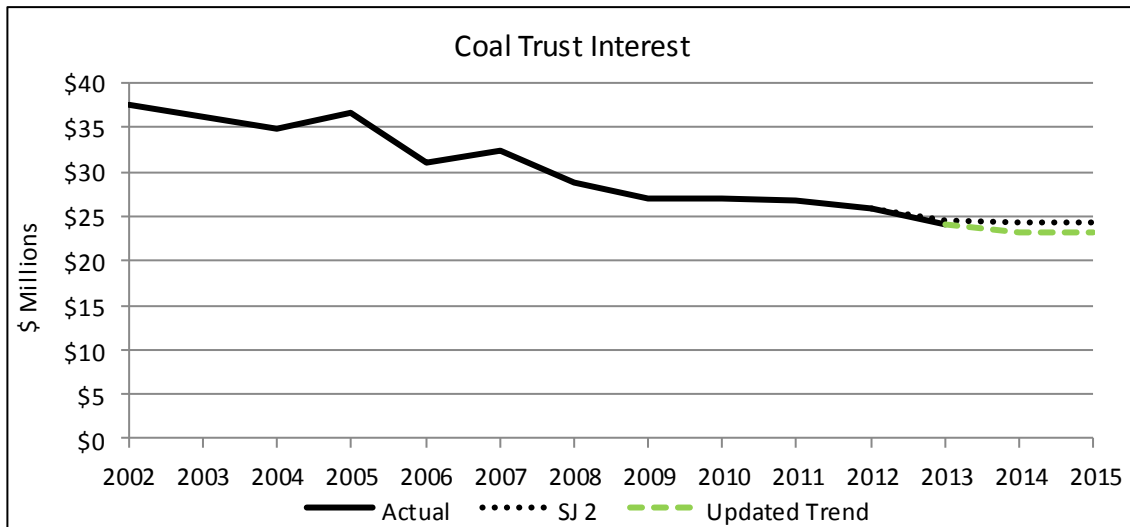
Wholesale energy transaction tax, imposed on transmission services providers, was \$0.5 million below the SJ 2 forecast in FY 2013. New surveys of energy transmission companies have been conducted since SJ 2 and the combined kilowatt hours for electrical transmission companies have been revised downward, closer to observed levels in FY 2013. The decrease primarily attributable to out-of-state transmissions is driving the reduction in the updated trend.



## Other Interest Earnings

### *Coal Trust Interest Earnings*

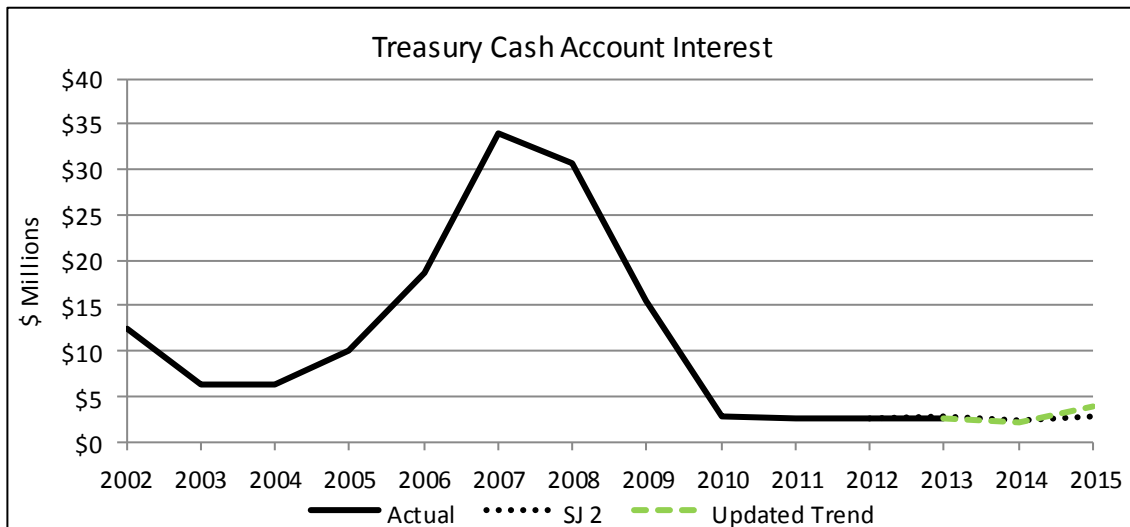
Coal trust earnings were below the estimate contained in SJ 2 by \$0.3 million. Revenue from this source is estimated using year-end balance amounts and forecast interest rates based on IHS estimates and suggestions from the Board of Investments (BOI).



The model used for this revenue forecast has not changed. The small discrepancy between SJ 2 estimates and the updated trend is due to a slightly smaller return rate than was forecast in SJ 2.

### *Treasury Cash Account Interest*

Based on year-end data for FY 2013, revenue from Treasury Cash Account (TCA) interest earnings was \$0.3 million below the estimate provided in SJ 2. Low interest rates continue to yield less-than-favorable rates of return for TCA interest earnings.

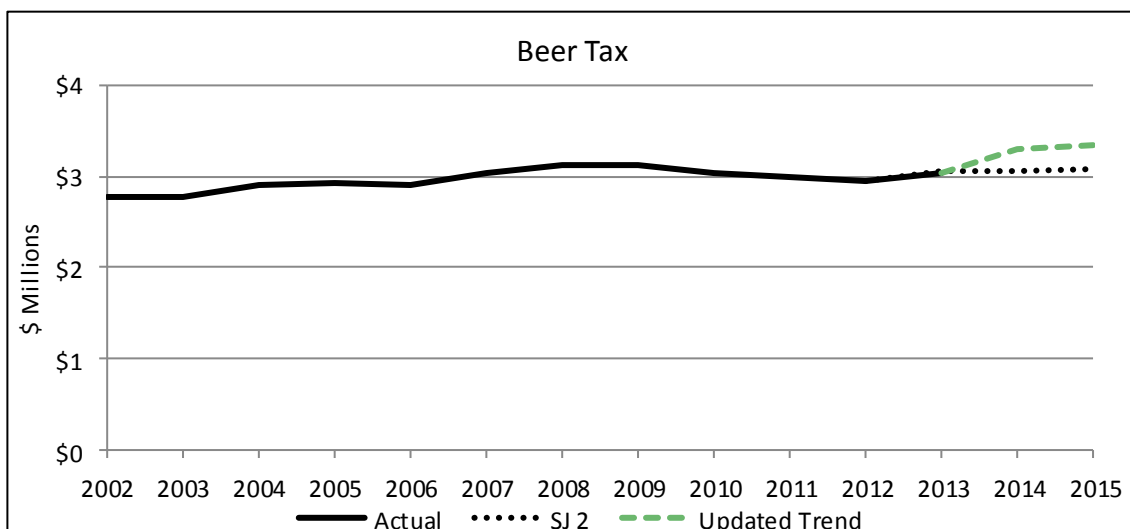


The updated trend is based on general fund projections as there is a strong correlation between the average treasury cash balance and total general fund revenue. Using the cash balance estimate, interest rates are forecast using IHS estimates and applied accordingly. Until interest rates begin to rebound, revenue from this source will continue to be far below historical amounts.

## Other Consumption Taxes

### *Beer Tax*

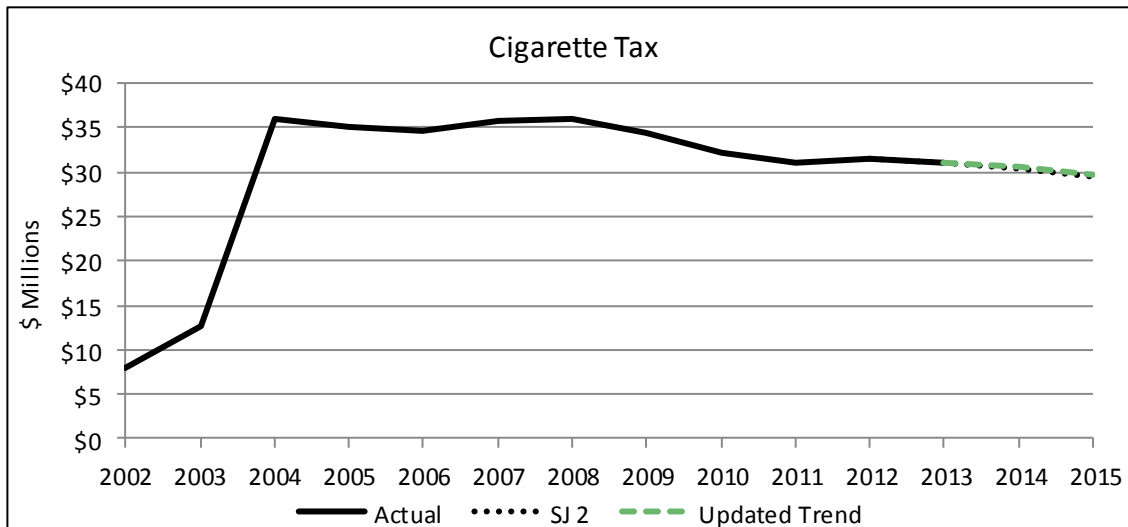
FY 2013 beer tax revenue came in just below the SJ 2 estimate. Although the estimate was low for the actual number of barrels sold, it was high for the effective tax rate. Both the SJ 2 estimate and the updated trend use a regression of a proxy for barrels sold against Montana retail sales and Montana's over-21 population. The increase in the updated trend is primarily due to the increase in forecast retail sales and population provided by IHS.



Also built into this update is a trend for the changing effective tax rate. The tax rate for distributors moving less than 5000 barrels per year is only \$1.30 per barrel, and for those distributing between 5,001 and 10,000 the rate is \$2.30, much less than the nominal \$4.30 for larger distributors. There is a small but steady decline in effective tax rate as the number of smaller breweries, and therefore smaller distributors, increases. The revised effective tax rate is based on growth trends for the various distributor sizes.

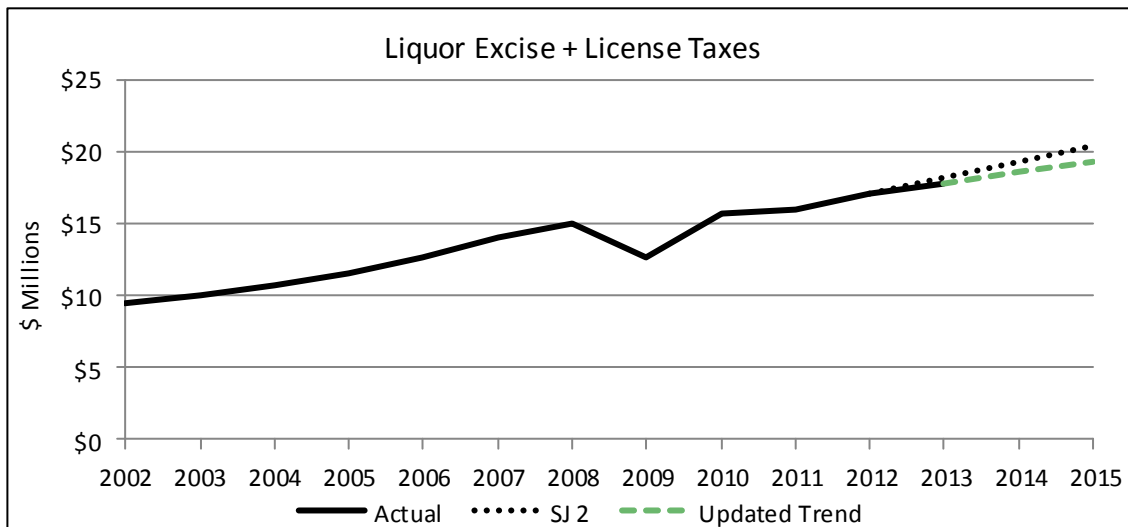
## ***Cigarette Tax***

Cigarette taxes slightly exceeded the SJ 2 revenue estimate in FY 2013. Since the tax rate stabilized at \$1.70/pack in 2006, tax revenue has been generally declining. Packs sold per year have declined since 1997, but have stabilized in recent years. For SJ 2, this revenue source was forecast using the independent ratio of the CPI for tobacco to consumer spending on tobacco products. The updated trend also incorporates the actual packs sold in the previous fiscal year.



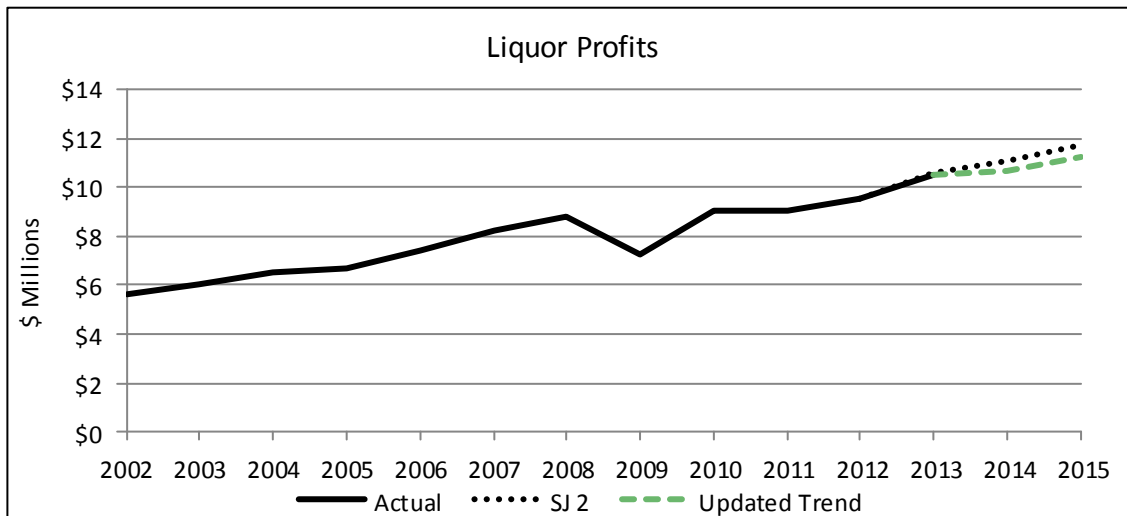
## ***Liquor Excise & License Tax***

Liquor excise tax revenue came in \$0.5 million under the FY 2013 estimate in SJ 2. The updated trend is simply adjusted to account for FY 2013 actual collections.



## ***Liquor Profits***

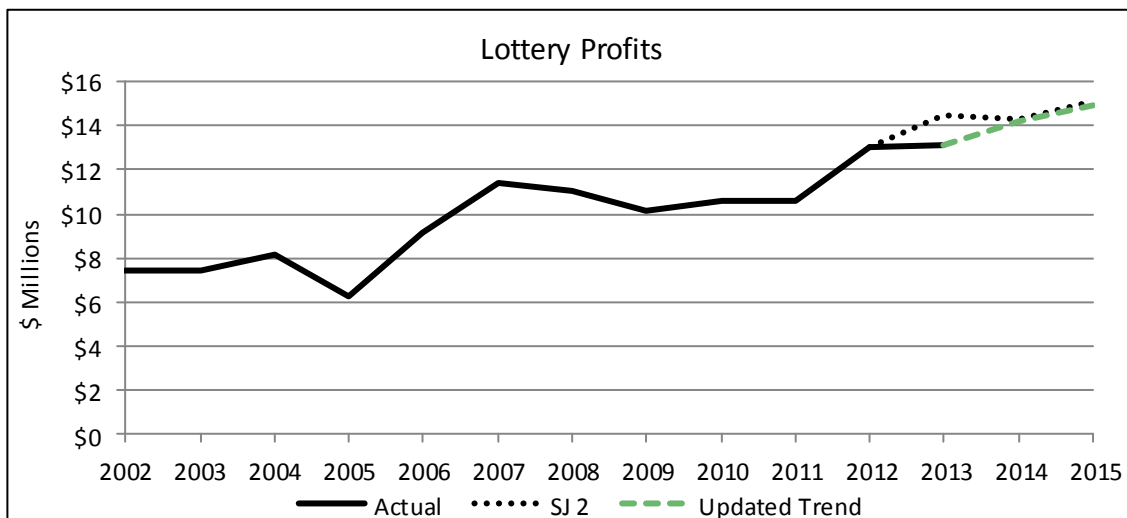
FY 2013 liquor profits came in at \$0.1 million below the estimate contained in SJ 2. Since the license and excise rates are constant, the updated trend accounts for the FY 2013 actual collections.



### ***Lottery Profits***

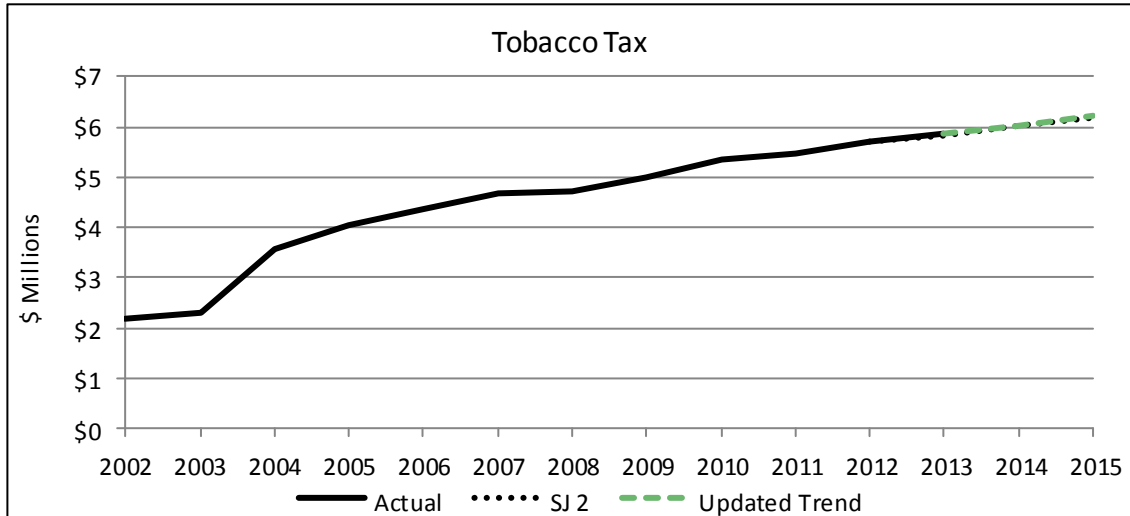
Lottery profits for FY 2013 came in \$1.4 million under the SJ 2 revenue estimate. In FY 2012, there was a transfer of \$0.5 million in appropriation authority from FY 2013, and in FY 2013 the Lottery received supplemental authority for \$2.0 million, of which it spent \$0.8 million. As a result, profits transferred in FY 2013 were reduced by about \$1.3 million. At the time of the SJ 2 estimate, information regarding the FY 2012 transfer was available; however, an adjustment was not incorporated into the estimate. The supplemental appropriation had not yet been made at the time of SJ 2.

Disregarding the one-time-only transfer and supplemental appropriation, the updated trend is still lower than the SJ 2 estimates for the next two years. FY 2013 sales were higher than projected in SJ 2, but the prize/ticket ratio was also higher, and incorporating those new numbers into the trend bring profits down slightly.



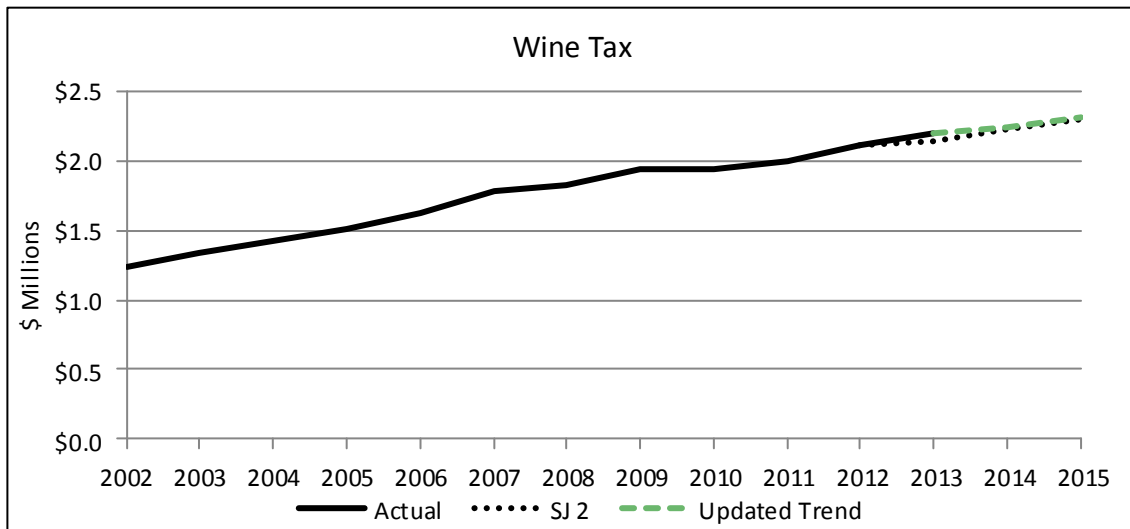
### ***Tobacco Tax***

Tobacco tax revenue came in over the SJ 2 estimate in FY 2013 by a very small amount. The underestimate for moist snuff balanced the overestimate for other non-cigarette tobacco products, resulting in a close overall estimate. The methodology for this revenue source has been updated, but the trend has changed little. Both moist snuff and other tobacco (non-cigarette) products are now forecast using the same variables Montana retail sales and Montana's over-18 population. The respective tax rates are then applied and the resulting amounts summed.



## Wine Tax

FY 2013 wine tax revenue was above the SJ 2 estimate by \$0.1 million. The updated trend includes FY 2013 actual collections and the updated population estimate from IHS.

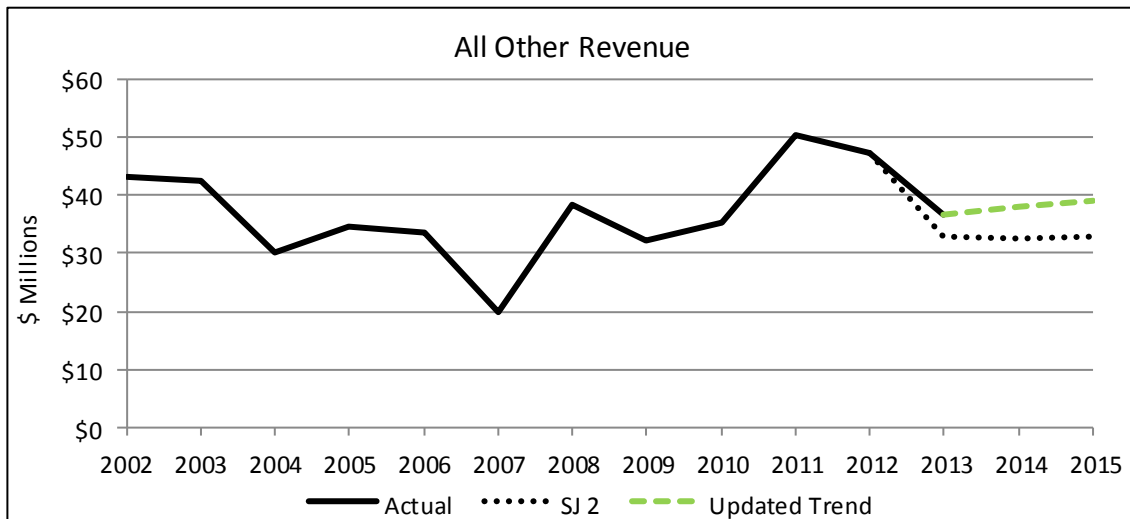


## Other Sources

### All Other Revenue

Combined revenue from all other general fund sources exceeded the SJ 2 estimate by \$3.7 million. This was due primarily to increased transfers to the general fund.

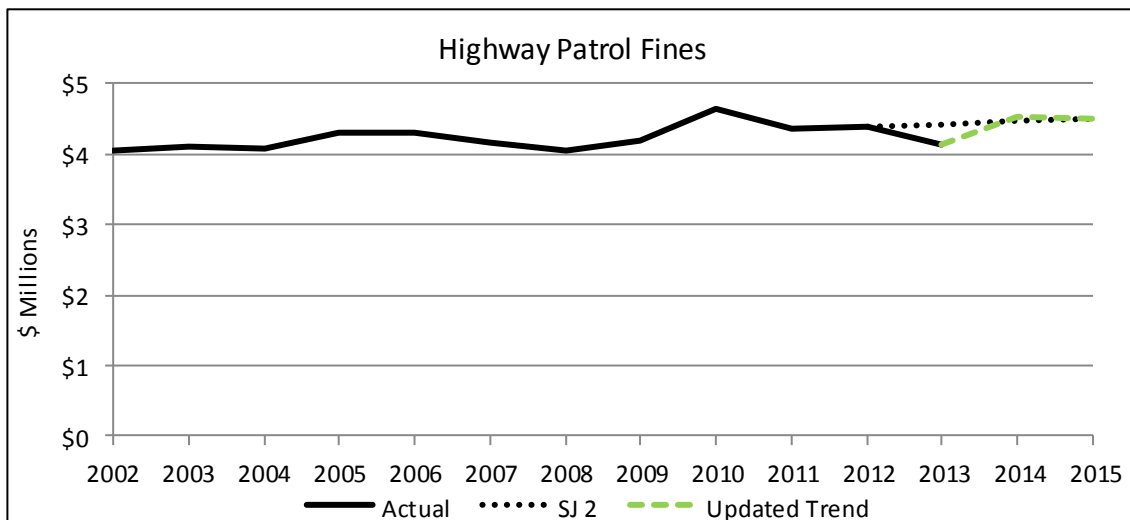




The modeling for this source has changed. Previously, numerous sources earning under \$1.0 million were estimated independently. They are now estimated aggregately. The remaining seven sources that typically earn over \$1.0 million are still estimated on an individual basis. The increased updated trend is primarily driven by actual collections in FY 2013.

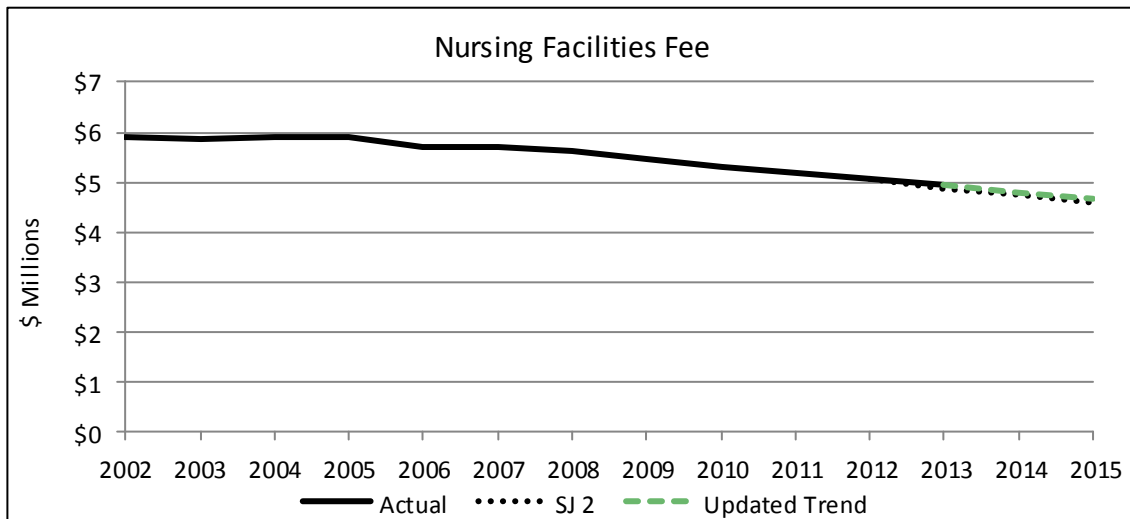
### ***Highway Patrol Fines***

Revenue generated from highway patrol fines in FY 2013 was \$0.3 million less than the estimate provided in SJ 2. The old model used the most recent per capita fine rate in forecast years. The revised model attempts to account for historical fluctuations to estimate the fine rate.



### ***Nursing Facilities Fee***

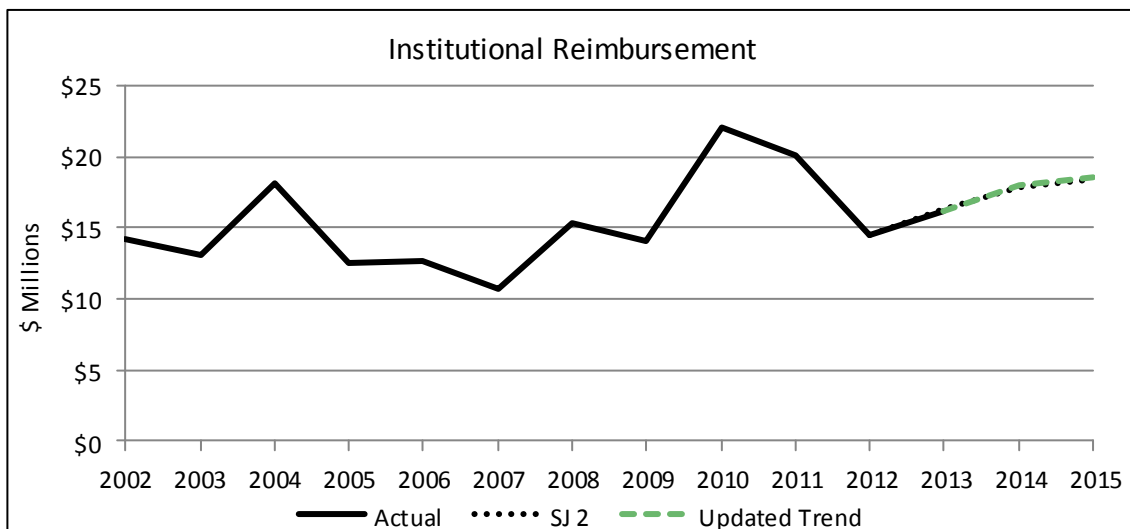
Nursing facilities fees came in \$0.1 million over the SJ 2 revenue estimate. This source has been on a linear decline since 2007. The update continues to use the same linear time trend approach from earlier estimates and includes FY 2013 collections, which produces a slightly higher estimate than SJ 2.



### ***Public Institution Reimbursements***

Public institution reimbursements were \$0.1 million less than SJ 2 in FY 2013. The updated trend is slightly higher than the SJ 2 estimate due to inclusion of the FY 2013 actual collections and higher-than-anticipated Medicaid payments. The increase in Medicaid payments appears to be due to higher costs per capita rather than an increase in bed days.

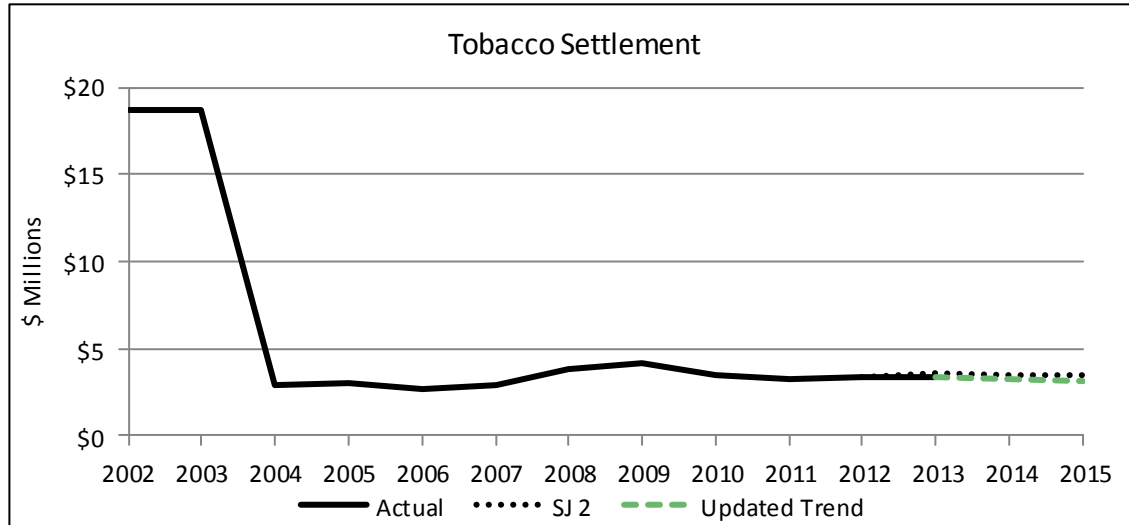
FY 2013 bed days were fewer than anticipated by the SJ 2 estimate, but three of the five facilities saw increases in Medicaid or Medicare eligible bed days. Additionally, per-bed-day contributions from Medicare and Medicaid due to changes in coverage were higher than forecast and higher than previous years.



In general, bed days are expected to continue to decline as community-based services become more available and better funded.

### ***Tobacco Settlement***

Tobacco settlement revenue was below the SJ 2 estimate by \$0.2 million for FY 2013 due to a decrease in market share. Changes in the tobacco settlement received by Montana are based on market share of the participating manufacturers and volume of cigarettes sold. The updated trend is slightly below that from SJ 2 due to including actual collections from FY 2013.



## **EXPENDITURES**

At this point in the year, general fund budget pressure is being seen in the two largest general fund spending areas: K-12 education and the Department of Public Health and Human Services (DPHHS). Non general fund budget pressures exist in the Montana University System and are described below.

### **HB 2 ANALYSIS INCLUDING ONE-TIME ONLY**

The following table illustrates the HB 2 and related bills (HB 13, HB 377, and HB 454) general fund appropriation authority. For this analysis, both ongoing appropriations of \$1,755.6 million and one-time-only appropriations of \$22.7 million are included. The analysis following the table also includes SB 410, as it is associated with the HB 2 budget.

Staff has analyzed the budgets relative to the portion of the fiscal year that has passed. Typically, through the first 10 pay periods 38.2% of personal services and 41.7% of other costs would be anticipated to be spent, leaving between 58% and 62% remaining authority. Staff reviewed the spending for all agencies in the three main fund types and investigated any anomalies. This analysis follows the HB 2 general fund table.

<b>FY 2014 HB 2 General Fund Spending Through November 30, 2013</b>				
<b>Section/Agency</b>	<b>Budget</b>	<b>Spending</b>	<b>Balance</b>	<b>% Remaining</b>
<b>A</b> Comm Of Political Practices	603,089	183,229	419,860	69.6%
Department Of Administration	6,449,061	2,323,090	4,125,971	64.0%
Department Of Commerce	6,722,882	1,578,834	5,144,048	76.5%
Department Of Labor & Industry	1,348,216	660,181	688,035	51.0%
Department Of Military Affairs	6,147,007	2,467,198	3,679,809	59.9%
Department Of Revenue	51,206,869	18,910,280	32,296,589	63.1%
Governor's Office	6,085,408	2,184,522	3,900,886	64.1%
Legislative Branch	12,274,326	4,572,677	7,701,649	62.7%
State Auditor's Office	1,646,660	0	1,646,660	100.0%
<b>A Total</b>	<b>92,483,518</b>	<b>32,880,013</b>	<b>59,603,505</b>	<b>64.4%</b>
<b>B</b> Health and Human Services	<b>447,461,338</b>	<b>159,726,389</b>	<b>287,734,949</b>	<b>64.3%</b>
<b>C</b> Department Of Agriculture	997,371	377,759	619,612	62.1%
Department Of Environmental Qualit	5,358,621	1,719,291	3,639,329	67.9%
Department Of Fish, Wildlife & Parks	309,125	89,020	220,105	71.2%
Department Of Livestock	1,536,904	442,995	1,093,909	71.2%
Dept Of Natural Resources & Conser	24,326,428	11,133,521	13,192,907	54.2%
<b>C Total</b>	<b>32,528,449</b>	<b>13,762,587</b>	<b>18,765,862</b>	<b>57.7%</b>
<b>D</b> Crime Control Division	2,376,839	905,432	1,471,407	61.9%
Department Of Corrections	181,822,901	65,322,524	116,500,377	64.1%
Department Of Justice	30,605,195	11,343,651	19,261,544	62.9%
Judicial Branch	38,387,321	13,457,125	24,930,196	64.9%
Office Of The Public Defender	26,963,146	10,506,159	16,456,987	61.0%
<b>D Total</b>	<b>280,155,402</b>	<b>101,534,891</b>	<b>178,620,511</b>	<b>63.8%</b>
<b>E</b> Board Of Public Education	215,614	59,234	156,380	72.5%
Commissioner Of Higher Education	208,757,649	95,113,142	113,644,507	54.4%
Montana Arts Council	584,062	189,504	394,558	67.6%
Montana Historical Society	3,508,464	1,187,277	2,321,187	66.2%
Montana State Library	3,284,828	1,508,879	1,775,949	54.1%
Office Of Public Instruction	702,734,653	291,082,217	411,652,436	58.6%
School For The Deaf & Blind	6,582,401	2,556,767	4,025,634	61.2%
<b>E Total</b>	<b>925,667,671</b>	<b>391,697,020</b>	<b>533,970,651</b>	<b>57.7%</b>
<b>Grand Total</b>	<b>1,778,296,378</b>	<b>699,600,899</b>	<b>1,078,695,479</b>	<b>60.7%</b>

## Agencies with Significant General Fund Appropriations

The following sections highlight the analysis of the agencies with highest general fund appropriation.

### *Office of Public Instruction*

The HB 2 general fund appropriation for local schools expenses is anticipated to be less than anticipated expenditures by approximately \$2 million due to an underestimation of guaranteed tax base aid (GTB) payments during the session.

A portion of the GTB payments are determined based on the district-anticipated funding from both fund balance reappropriated and non-levy revenue. These funds offset state general fund GTB payments and local levies. Any change in this area is shared between state general fund and local levies. State analysts estimate these funding amounts during session and both were overestimated as follows: 1)fund balance re-appropriated (\$5 million), which is very volatile and cannot be forecast with certainty and 2)non-levy revenue (\$2 million) from oil and gas. The combined difference between expected and actual is \$7 million and resulted in both higher guaranteed tax base aid (GTB) payments from the state to districts and higher local BASE mills.

Two factors were observed in the district oil and gas revenue budgeting in the GTB area:

1. Overall districts budgeted less oil and gas revenue in the district general fund than anticipated.
2. In FY 2014, SB 175 allowed districts to use a portion of the non-levy revenue in the district general fund above BASE for the first time. The fiscal note assumed there would be no impact to the GTB payments from this provision.

The state special funding available for school BASE aid, the guarantee account revenues, are anticipated to be consistent with budgeted levels and are not anticipated to be available to offset this shortfall. In addition, the trigger set forth in SB 175 that would allocate “excess” guarantee account revenue to other school purposes is not expected to be met.

### ***Department of Public Health and Human Services (DPHHS)***

Most agencies do not report a forecast of fiscal year end budget status to the legislature in mid-year, but only report to the LFC if the agency cannot manage to the budget and needs to transfer funds from the second year of the biennium to the first. DPHHS has specific statutes that require midyear reports on final budget estimates (53-6-110, MCA).

#### The DPHHS Budget Status Report

The November 15 budget status report (BSR) projects a \$10.2 million general fund shortfall for FY 2014 based on Medicaid paid claims through September 27. Eleven of the 15 divisions in DPHHS are projecting over-expenditure of general fund appropriations, with the majority of the overruns reported in Medicaid services (\$7.7 million). At this time, the LFD has not had the opportunity to do an independent analysis of the Medicaid fiscal year-end forecasts but will have this analysis prepared for the March LFC meeting.

The following summary illustrates the pressure points as described by the DPHHS:

Health Resources Division - \$5.7 million (56% of the total)

- Medicaid hospital services - \$3.4 million, with one major factor being higher reimbursement due to more complex patient acuity
- Medicaid physician services - \$1.2 million due to more persons accessing services and rate increases in HB 2 and 53-6-125(b), MCA, which ties provider reimbursement to the consumer price index for medical care as calculated by the U.S. Department of Labor

Developmental Services Division - \$1.7 million (17% of the total)

- Children’s mental health services - \$1.4 million

Director’s Office - \$1.3 million (13% of the total)

- Personal services - \$1.3 million due to projected payouts for retiring employees, which are funded by transfers from programs across the department

Child and Family Services Division - \$1.2 million (12% of the total)

- Foster care and subsidized guardianship services - \$0.5 million due to increases in caseload mainly associated with increased methamphetamine and prescription drug abuse. The current foster care caseload is the highest it has ever been at a total of 2,261 children as of October 31. While projections for FY 2014 included some growth in caseload, which was funded, the increase has been greater than anticipated.
- Regional administration - \$0.4 million due to continuation of 13.50 modified FTE, which were not funded by the legislature

#### Potential Mitigation Strategies

While the DPHHS budget status report is not required to describe efforts being made in DPHHS to mitigate cost overruns, LFD staff has begun this analysis. The next section describes some potential DPHHS cost overrun mitigation strategies. Research on options will continue and be presented at future LFC meetings.

### *SB 410 Funds Available*

SB 410 includes a \$2.0 million biennial state special revenue appropriation to DPHHS for the purpose of funding various operations, benefits, and grant costs. SB 410 funds are not allocated at this point in time.

SB 410 also includes a \$7.5 million biennial state special revenue appropriation to the Governor's Office of Budget and Program Planning (OBPP) to fund operations costs of various state agencies, including DPHHS. These funds could be used to offset the shortfalls shown above.

### *Additional State Special Funds*

Insurance tax proceeds benefit both the general fund and the Healthy Montana Kids (HMK) state special revenue fund. As described in the revenue section of this report on page 19, the Blue Cross/Blue Shield merger will increase insurance tax proceeds. The FY 2014 estimated additional Healthy Montana Kids (HMK) state special revenue is \$2.6 million above the SJ 2 estimate. The additional HMK state special revenue could be used to offset the general fund state match for Medicaid services for children in the Health Resources and Developmental Services Divisions. Depending on available state special appropriation authority in DPHHS, the increase in authority for spending these funds may require a state special supplemental appropriation from the next legislature.

### ***Department of Corrections***

At this point, the Department of Corrections appears to have sufficient appropriation authority to meet its obligations for FY 2014. The department has established the \$2.0 million appropriation from SB 410 in the Administration and Financials Division but is still in the process of determining how the funding will be used.

Outside medical costs that caused significant budget challenges in FY 2013 are running at only 78.6% of the expenditures in FY 2013 for the first five months of FY 2014. As of this point in the fiscal year 80.5% of the FY 2014 funding provided by the legislature remains unexpended.

As an update to budget information discussed last session, 4.00 FTE were transferred from Youth Services to Secure Custody Facilities to support the memorandum of understanding (MOU) with DPHHS for the operation of the Lewistown Infirmary. These same positions were transferred in FY 2013 and will need to be transferred in FY 2015 since they were not reflected in the legislative budget. In addition, 5.00 modified FTE have been established to maintain security within the facility. No expenditures have been made from the \$1.3 million general fund appropriation for FY 2014 to fund this MOU as the accrual of FY 2013 appropriations restricted to addressing population growth will fund the costs for FY 2014.

### ***Office of the Commissioner of Higher Education (OCHE)***

The Montana University System (MUS) has significant tools to manage within their budgets due to the funding and budget control retained by the Board of Regents. Budget shortages on campuses are unlikely to directly impact the state budget. However, budget shortfalls, even in non-state areas of the budget, may impact budget policy and development in the next legislative session. The following analysis of the MUS budgets does not reflect immediate state budget impacts, but is expected to be a part of the budget discussion in the 2015 session.

#### The University of Montana (UM)

The UM is expecting a shortfall of \$3 million in the fall semester and \$3.2 million in the spring semester due to declines in enrollment. In the fall of 2012, the university saw an enrollment dip of 700 students. The university saw a peak in enrollment in FY 2011 and FTE has steadily been decreasing since then while expenses have continued to increase.

The fall semester shortfall is expected to be remedied by small budget adjustments including delaying some projects, leaving positions open, and finding utility savings. The spring semester shortfall is still being discussed. The school plans to evaluate items such as motor pool, academic programs, faculty needs, and recruitment. The school has put

together five new groups to analyze operations and resources: enrollment management, revenue enhancement, resource allocation, cost savings, and academic programming. Budget updates will be posted at this website:

<http://www.umt.edu/adminfin/FY%2014%20Budget.aspx>

#### Montana State University (MSU)

The MSU research office is facing a \$3.5 million shortfall for FY 2014. Factors include the end of stimulus funding, sequestration, fewer grants being requested, and lower award amounts for grants. University administration has pledged \$2 million from the central MSU resources, and the university has put together a task force of faculty and staff to give budget recommendations to solve the remaining \$1.5 million shortfall. An official update is expected to be presented at the January Board of Regents meeting.

## **Other Significant Budget Comments**

### ***Section A: General Government***

#### Department of Military Affairs

The Department of Military Affairs was the agency within state government that was most impacted by the federal shutdown. Traditional drills scheduled for October 5 and 6 were canceled for 3,755 guardsmen. Once the federal government reopened, “make up” days were authorized. In addition, 583 federal full-time guardsmen were furloughed from October 1 through the 7<sup>th</sup>. They received retroactive pay once the shut-down ended.

#### Department of Commerce (Commerce)

Much of the Commerce general fund and federal fund budget is for grants and/or programs that provide grant funds to businesses and local governments. The general fund HB 2 appropriation has 76.5% of the appropriation remaining and the federal funds have 91% remaining. Expenditures for the grants historically do not occur evenly throughout the fiscal year with the application process conducted at the beginning of the year and grant awards occurring later, as reflected by the percentage of budget authority remaining.

#### State Auditor (SAO)

The SAO received a one-time, biennial appropriation of \$8.4 million general fund to bridge the Insure Montana program to the new federal Affordable Care Act (ACA). Insure Montana provides premium assistance and tax credits for health insurance. The general fund appropriation is in addition to \$8.2 million state special revenue. To date, none of the general fund has been expended and the state special revenue appropriation has 69.5% remaining. This program will be followed closely as the ACA is implemented.

#### Department of Labor and Industry (DLI)

SB 410 provided \$2.0 million in general fund for the DLI. The agency has allocated \$1.0 million within three divisions:

- \$824,432 Workforce Services Division
- \$125,000 Employment Relations Division
- \$50,000 Community Services Division

### ***Section C: Natural Resources and Transportation***

#### Department of Natural Resources and Conservation (DNRC)

The department has 54.2% of the HB 2 general fund appropriation remaining. This higher than average spending is due primarily to fire suppression costs being initially recorded in DNRC’s Forestry program’s general fund HB2 budget and periodically transferred to the fire suppression fund.

#### Department of Transportation (MDT)

Current spending patterns are similar to previous fiscal years. The current federal transportation funding bill (MAP 21) expires September 30, 2014. Future budget updates will track the new surface transportation bill progress through Congress.

## ***Section D: Judicial Branch, Law Enforcement, and Justice***

### Department of Justice (DOJ)

HB 76 of the 2013 Legislature established a child and family ombudsman in DOJ. The legislature approved funding for the ombudsman in the Legal Services Division. The executive has approved a program transfer that moves \$125,000 in funding and 1.00 FTE from the Legal Services Division to the Division of Criminal Investigation. The ombudsman position remains vacant and no personal services expenditures have occurred this fiscal year. To date, \$1,700 has been expended for services under contract.

The legislature appropriated \$2.0 million for the 2015 biennium for litigation over water rights issues with Wyoming. Of this funding, \$715,427, or 36% has been recorded through November. The trial hearing concluded on December 4, 2013, so trial expenses remain to be paid for bills received after November. Expectations are that the special master hearing the case will rule sometime within the next six months.

### Public Defender

The legislature funded a career ladder for public defender attorneys in addition to the funding in HB 13, the state pay plan. Attorney turnover has slowed significantly and the Office of State Public Defender is at risk of not achieving vacancy savings expectations.

Through five months of the fiscal year, 60% of the \$500,000 biennium funding for capital defense has been expended. Of the current year expenditures, 89% of the costs have been on cases associated with the murder of the Sydney school teacher. In a plea deal, the state may withdraw the death penalty for one of the two. The state has withdrawn the death penalty for the case against the Montana State Prison inmate for killing a fellow inmate.

## ***Section E: Education***

### State Library

Spending is on target compared to previous biennia, although general fund expenditures show 54.1% appropriation remaining. The larger percentage expenditure compared to the timing in the budget cycle is due to the fact that the general fund appropriation supports the statewide interlibrary resource-sharing program and state aid to libraries throughout Montana. These two appropriations are distributed early in the budget cycle. If these appropriations are excluded the library has approximately 72.8% of the general fund appropriation remaining. The resource-sharing and state aid expenditures account for approximately 18% of the general fund appropriation.

The Library fully moved the Base Map Service Center (BMSC) in FY 2014 from the State Information Technology Services Division in the Department of Administration (SITSD). The Library was appropriated \$953,359 and 2.5 FTE to bring in the BMSC for the 2015 biennium.

## **STATUTORY**

Statutory appropriations are those appropriations that are contained in the Montana Code Annotated to be established each year based on specific criteria in law. Spending is capped by the law establishing the appropriation and not a dollar amount approved every two years. These appropriations are established on the SABHRS accounting system as needed by the executive and can be adjusted at any time in the fiscal year. Likewise, the executive establishes the Governor's emergency appropriations as needed. The table below assumes that half the biennial appropriation is established. The balance sheet on page 2 reflects the session legislative estimates for statutory appropriations.



Updated information is becoming available on the costs of various statutory appropriations. These estimates will be updated in the March budget status report.

<b>FY 2014 Statutory GF Spending Through November 30, 2013</b>				
<b>Section/Agency</b>	<b>Budget</b>	<b>Spending</b>	<b>Balance</b>	<b>% Remaining</b>
<b>A Department Of Administration</b>	98,782,467	53,603,310	45,179,157	45.7%
<b>Department Of Revenue</b>	118,249,854	28,123,034	90,126,820	76.2%
<b>Governor' Emergency Appropriation</b>	8,250,000	212,788	8,037,212	97.4%
<b>Department Of Commerce</b>	2,376,172	1,684,780	691,392	29.1%
<b>State Auditor's Office</b>	27,999,539	0	27,999,539	100.0%
<b>A Total</b>	<b>248,143,588</b>	<b>83,623,879</b>	<b>164,519,709</b>	<b>66.3%</b>
<b>C Department Of Agriculture</b>	690,000	191,643	498,357	72.2%
<b>D Department Of Justice</b>	4,568,241	1,888,527	2,679,714	58.7%
<b>E Commissioner Of Higher Education</b>	1,360,541	417,246	943,295	69.3%
<b>Grand Total*</b>	<b>254,762,370</b>	<b>86,121,295</b>	<b>168,641,075</b>	<b>66.2%</b>
Total Statutory appropriations do not tie to Figure 1 since these levels reflect the amount of statutory appropriation levels established on SABHRS as of November 1, 2013 by the Executive, plus half of the biennial emergency appropriation level. Figure 1 reflects LFD estimates of the final spending of the same.				

## Department of Administration (DOA)

The primary statutory appropriations in DOA are for debt service and pension contributions on behalf of local governments. Two factors make the year to date spending appear higher than average: 1) the debt service payments are primarily paid in August; and 2) the HB 377 \$25 million payment to the Teachers' Retirement System occurred in July.

## Department of Revenue

The Department of Revenue statutory appropriations are primarily the entitlement share payments made to local governments. These payments are distributed in four installments and one quarter were paid in the first five months of FY 2014.

## Department of Commerce (Commerce)

The statutory appropriations in Commerce include a \$1.275 million transfer to the Research and Commercialization Account that was fully transferred at the beginning of the fiscal year and causes the percent remaining to be low.

## OTHER (INCLUDING NON-HB 2 OTO)

Many of the other appropriations have specific spending schedules. Many are biennial and may not be spent until the second year of the biennium.

<b>FY 2014 HB 2 Other Spending Through November 30, 2013</b>				
<b>Section</b>	<b>Budget</b>	<b>Spending</b>	<b>Balance</b>	<b>Remaining</b>
<b>A: General</b>	5,820,601	604,172	5,216,429	90%
<b>B: Health &amp; Human</b>	67,000	0	67,000	100%
<b>C: Natural Resources</b>	1,260,704	355,577	905,128	72%
<b>D: Public Safety</b>	558,245	0	558,245	100%
<b>E: Education</b>	12,938,942	450,876	12,488,066	97%
<b>Total</b>	<b>20,645,492</b>	<b>1,410,625</b>	<b>19,234,868</b>	<b>93%</b>



## ***Section A: General Government***

The largest appropriations in General Government are:

1) The \$3.3 million in HB 1 Feed Bill appropriations that continues from the 2013 session into the 2015 session. This appropriation is not anticipated to have significant expenditures in FY 2014; and 2) \$1 million for executive branch pay plan contingency funding from HB 13, which will be allocated by the executive over the biennium as needed. Typically allocations are made at the end of each fiscal year as need for these funds is clearer.

## ***Section C: Natural Resources and Transportation***

The largest appropriation in natural resources is \$790,000 in FY 2014 for aquatic invasive species from HB 586. It appears expenditures are being made as anticipated.

## ***Section E: Education***

The largest appropriations in education are for the SB 175 school funding bill that allocated \$12.9 million in FY 2014. Very little of this appropriation has been expended to date, but will be available for overall BASE Aid spending. The discussion of this appropriation is included in the Office of Public Instruction write up under the HB 2 section.

## **REFERENCE TABLES OF STATE SPECIAL AND FEDERAL FUND FOR HB 2 AND RELATED BILLS**

The following tables show federal and state special appropriation, actual spending, and remaining authority. These tables are the same budget information contained as in the general fund spending chart on page 35.

<b>FY 2014 HB 2 State Special Spending Through November 30, 2013</b>				
<b>Section/Agency</b>	<b>Budget</b>	<b>Spending</b>	<b>Balance</b>	<b>% Remaining</b>
<b>A</b> Consumer Council	1,656,896	456,447	1,200,449	72.5%
Department Of Administration	6,543,238	2,472,143	4,071,095	62.2%
Department Of Commerce	7,503,747	988,540	6,515,207	86.8%
Department Of Labor & Industry	59,613,848	18,975,431	40,638,417	68.2%
Department Of Military Affairs	2,298,892	457,424	1,841,468	80.1%
Department Of Revenue	1,120,063	309,639	810,424	72.4%
Governor's Office	8,409	0	8,409	100.0%
Legislative Branch	2,573,718	861,381	1,712,337	66.5%
State Auditor's Office	17,977,812	5,528,972	12,448,840	69.2%
<b>A Total</b>	<b>99,296,623</b>	<b>30,049,976</b>	<b>69,246,646</b>	<b>69.7%</b>
<b>B</b> Department of Public Health and I	<b>154,081,813</b>	<b>28,427,510</b>	<b>125,654,303</b>	<b>81.6%</b>
<b>C</b> Department Of Agriculture	13,817,392	3,460,060	10,357,332	75.0%
Department Of Environmental Qu	32,699,477	9,356,965	23,342,512	71.4%
Department Of Fish, Wildlife & Pa	57,774,680	20,428,254	37,346,426	64.6%
Department Of Livestock	7,721,721	2,866,437	4,855,284	62.9%
Department Of Transportation	249,330,599	97,612,538	151,718,061	60.9%
Dept Of Natural Resources & Cons	35,028,228	8,617,613	26,410,615	75.4%
<b>C Total</b>	<b>396,372,097</b>	<b>142,341,868</b>	<b>254,030,229</b>	<b>64.1%</b>
<b>D</b> Crime Control Division	236,806	49,442	187,364	79.1%
Department Of Corrections	5,925,529	1,292,997	4,632,532	78.2%
Department Of Justice	54,354,449	19,359,483	34,994,966	64.4%
Judicial Branch	2,559,834	897,963	1,661,871	64.9%
Office Of The Public Defender	281,544	107,172	174,372	61.9%
Public Service Regulation	3,761,309	1,312,050	2,449,259	65.1%
<b>D Total</b>	<b>67,119,471</b>	<b>23,019,108</b>	<b>44,100,364</b>	<b>65.7%</b>
<b>E</b> Board Of Public Education	171,810	53,408	118,402	68.9%
Commissioner Of Higher Educati	20,792,759	2,746,110	18,046,649	86.8%
Montana Arts Council	223,492	73,461	150,031	67.1%
Montana Historical Society	712,724	229,039	483,685	67.9%
Montana State Library	1,801,798	869,164	932,634	51.8%
Office Of Public Instruction	10,598,368	49,315	10,549,053	99.5%
School For The Deaf & Blind	263,080	14,828	248,252	94.4%
<b>E Total</b>	<b>34,564,031</b>	<b>4,035,325</b>	<b>30,528,706</b>	<b>88.3%</b>
<b>Grand Total</b>	<b>751,434,035</b>	<b>227,873,787</b>	<b>523,560,248</b>	<b>69.7%</b>

<b>FY 2014 HB 2 Federal Spending Through November 30, 2013</b>				
<b>Section/Agency</b>	<b>Budget</b>	<b>Spending</b>	<b>Balance</b>	<b>% Remaining</b>
<b>A</b> Department Of Administration	947,529	0	947,529	100.0%
Department Of Commerce	17,613,162	1,580,260	16,032,903	91.0%
Department Of Labor & Industry	38,854,252	9,506,205	29,348,047	75.5%
Department Of Military Affairs	54,126,965	14,871,911	39,255,054	72.5%
Department Of Revenue	257,449	105,610	151,839	59.0%
Secretary Of State's Office	128,000	30,245	97,755	76.4%
<b>A Total</b>	<b>111,927,357</b>	<b>26,094,230</b>	<b>85,833,127</b>	<b>76.7%</b>
<b>B</b> Department of Public Health and I	<b>1,355,693,642</b>	<b>410,223,914</b>	<b>945,469,728</b>	<b>69.7%</b>
<b>C</b> Department Of Agriculture	2,104,443	337,651	1,766,792	84.0%
Department Of Environmental Qu	20,329,768	6,320,130	14,009,638	68.9%
Department Of Fish, Wildlife & Pa	19,525,151	6,747,869	12,777,282	65.4%
Department Of Livestock	1,429,924	396,784	1,033,140	72.3%
Department Of Transportation	430,162,378	210,724,533	219,437,845	51.0%
Dept Of Natural Resources & Cons	2,010,224	323,965	1,686,259	83.9%
<b>C Total</b>	<b>475,561,888</b>	<b>224,850,932</b>	<b>250,710,957</b>	<b>52.7%</b>
<b>D</b> Crime Control Division	9,723,575	1,891,000	7,832,576	80.6%
Department Of Corrections	16,005	0	16,005	100.0%
Department Of Justice	1,120,160	277,647	842,513	75.2%
Judicial Branch	123,002	46,352	76,650	62.3%
Public Service Regulation	73,334	73,334	0	0.0%
<b>D Total</b>	<b>11,056,076</b>	<b>2,288,332</b>	<b>8,767,744</b>	<b>79.3%</b>
<b>E</b> Commissioner Of Higher Education	57,407,158	17,497,446	39,909,712	69.5%
Montana Arts Council	709,793	307,046	402,747	56.7%
Montana Historical Society	742,841	287,277	455,564	61.3%
Montana State Library	1,664,665	407,817	1,256,848	75.5%
Office Of Public Instruction	174,419,827	44,302,027	130,117,800	74.6%
School For The Deaf & Blind	71,760	2,909	68,851	95.9%
<b>E Total</b>	<b>235,016,044</b>	<b>62,804,522</b>	<b>172,211,522</b>	<b>73.3%</b>
<b>Grand Total</b>	<b>2,189,255,008</b>	<b>726,261,929</b>	<b>1,462,993,079</b>	<b>66.8%</b>